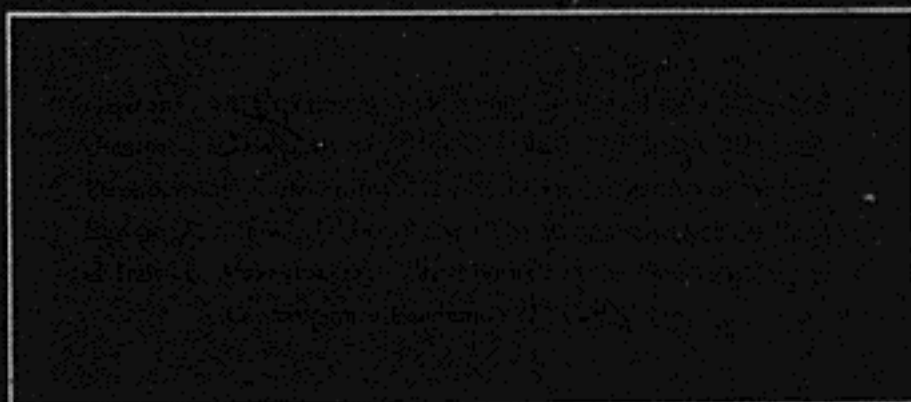


BANCA NAZIONALE DEL LAVORO
QUARTERLY REVIEW



R O M E

1950

BANCA NAZIONALE DEL LAVORO

HEAD OFFICE: ROME
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Condensed Statement of Condition, June 30th, 1950

ASSETS		LIABILITIES	
(Lire)			
Cash, Balances with Banks & Money at call	76,657,198,580	Capital	1,150,000,000
Investments {	Govt. & semi-Govt. Securities & Treasury Bills	Ordinary Reserve Fund	1,360,000,000
	Other Securities		2,510,000,000
	Contango, Advances on Securities & Loans	Deposits & Current Accounts (Including Balance of Profit & Loss)	214,857,000,709
Bills receivable & Re-discounts	59,274,231,819	Cheques in Circulation (<i>assegni circolari</i>)	10,270,556,669
Sundry Accounts	480,088,468	Bills for Collection	9,989,897,487
Premises, Furnitures & Fixtures	1	Guarantees & Acceptances for A/C of Customers	21,825,717,229
Customers' Liability for Guarantees & Acceptances	21,825,717,229	Sundry Accounts	15,984,455,017
	281,956,271,091	Staff individual Retirement Accounts	4,701,602,419
Securities deposited by Third Parties	48,180,294,626	Unearned Discount & other unearned Income	1,817,041,561
Special guaranteed Accounts	11,652,747		281,956,271,091
Staff Assistance & Retirement Fund-Securities deposited by the Bank as Guarantee	4,195,455,960	Depositors of Securities	48,180,294,626
	334,343,674,424	Accounts guaranteeing special Accounts	11,652,747
		Bank's Securities guaranteeing staff Assistance & Retirement Fund	4,195,455,960
			334,343,674,424

AUTONOMOUS SECTIONS FOR SPECIAL CREDITS

SECTION FOR CREDIT TO MEDIUM AND MINOR INDUSTRIES

Capital and Government Guarantee Fund L. 2,297,100,000

SECTION FOR HOTEL AND TOURIST CREDIT

Aggregate Capital and Reserves L. 425,166,741

SECTION FOR CO-OPERATIVE CREDIT

Capital L. 500,000,000 - Government Guarantee L. 2,000,000,000

SECTION FOR MORTGAGE CREDIT

Aggregate Capital and Reserves L. 252,454,962

SECTION FOR CINEMA CREDIT

Aggregate Capital and Reserves L. 453,398,521

SUMMARY

The economic policy introduced in Germany in the middle of 1948 by the monetary reform and the return to a price mechanism is discussed and severely criticised by Prof. Thomas Balogh, in the study: "Germany: an Experiment in Planning by the «Free» Price Mechanism". The decisively controversial position assumed by Prof. Balogh in regard to the prevalent line of thought on this complicated matter, is summarised by the A. at the beginning of his article in the following points:

1) little if any of the improvement in production can be attributed to the decontrol measures; it was mainly due to the restoration of money economy after the system of blackmarket barter which had evolved during the chaos following the collapse of the Nazi regime; and to the sudden increase in American supplies;

2) the iniquitous formulae adopted for the currency reform resulted in a violent increase in social inequality; the simultaneous decontrol measures and the repeated regressive tax-reforms have not merely further aggravated social injustice and irresponsibility but also caused a flight into spending and goods to escape liabilities; consequently an open inflationary pressure made itself felt; consequently;

3) as there were no means left to canalise demand towards innocuous uses, harsh general measures had to be taken to cut demand generally;

4) employment therefore could hardly be increased, and unemployment mounted rapidly despite hugely increased imports and the consequent disappearance of bottlenecks which prevented fuller recovery before the currency reform;

5) the productive effort of the country is far below its potential capacity; such productive effort and especially investment as exist are to a considerable extent misdirected towards luxury consumption and investment; the main-basis of German industry, on which its competitive power depends, has been undermined; any effort to recreate it will involve a serious crisis, the inevitability and gravity of which will be increased with the passing of time;

6) the weakness of the balance of payments despite the savage deflation practised shows the total irresponsibility both of the Government which encourages the inflation of higher incomes, and of their owners who recklessly consume it; the position is further aggravated by a large scale capital flight; the foreign viability of the country cannot be restored by present policies;

7) the social iniquity, the inability to distribute the war-burden over the whole of the population; the failure to settle the refugees and absorb the unemployed, inevitably favour extremism; the fear of Russia and the memory of the fake-prosperity under the Nazis will, if a thorough change of present policy is not enforced, unquestionably drive the Germans into a dangerous political impasse which might imperil the peace of the world.

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The article by Prof. Sergio Steve "Fiscal Policy and Italy's Economic Development" links up with the more recent literature in the field of fiscal theory; the relations

between fiscal policy and the size of national income. In the framework of this theoretical trend, the A. considers the part that should be played by an active fiscal policy for promoting the development of Italian economy, and more especially the recovery of the depressed and backward areas of the South. In this connection, he stresses a structural feature of the Italian economy, where we find side by side highly industrialised regions, whose problems are similar to those of mature economies, and extensive backward and depressed areas. Prof. Steve observes that while this situation does not allow of the application of policies elaborated for mature economies, neither does it present the difficulties met with in countries in the early stages of industrialisation, as the different aspects of Italian economy might find profitable opportunities for cooperation and integration in a nation-wide programme of economic development.

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The article "*The Economic Integration of Western Europe*", by Prof. Francesco Coppola D'Anna, is not a further description of the obvious reasons for which European Union is a necessary foundation for the salvation of the Old Continent. Leaving on one side the easy field of wishful anticipations, the A. examines the historical problems involved in the realisation of this proposed Union and illustrates fully its serious and complex nature, viewed from the economic and political standpoints. The position he takes up is far from being a negative one, but it is critical of the too hasty and doctrinaire approaches made, even in some official circles, to the consideration of a matter that requires a thorough understanding of the risks, the losses, the uncertainties, and the renunciations it would involve, and therefore calls for an extremely cautious and slow action.

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"*The Balance-Sheet of the Bank of Italy*", by Dr. Livio Magnani, describes the nature and consistency of the several items on the balance-sheet of the Bank of Italy, as they have developed in the past ten years, during which economic vicissitudes have led to important alterations in its construction.

•••

"*Contributions to the Understanding of Contemporary Economics*", by Prof. Federico Caffè, is a review of three important volumes published in the last few years by the American Economic Association. The A. gives an account of the frequently controversial reactions aroused, more especially by one of the volumes, "*A Survey of Contemporary Economics*". Summarising the views of some eminent writers (Stigler, Robertson) on the development of economic science in the last decades, the A. considers that some of the remarks expressed are unduly pessimistic and seem to him unjustified by the present state of the science. In his opinion, the volumes reviewed make an important contribution to the understanding of contemporary economics and they point to the lines along which it is evolving, in a direction which coordinates theoretical analysis with practical testing.

The Banca Nazionale del Lavoro assumes no responsibility for opinions or facts stated by authors whose contributions are published in the present Review.

All communications regarding the Review should be addressed to Banca Nazionale del Lavoro, Ufficio Studi, Roma, Via Vittorio Veneto 119.

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Stabilimento Aristide Staderini - Roma - Via Crescenzo, 2

Germany: an Experiment in Planning by the "Free," Price Mechanism

by
THOMAS BALOGH

The example of the Western German experiment in decontrol coupled with severe monetary deflation is freely quoted in support of « planning by the price mechanism » (1).

(1) Cf. especially Professor F. A. LUTZ, "*The German Currency Reform and the Revival of the German Economy*", *Economica*, May 1949, and Professor HASSELER, "*Economic Aspects of a European Union*", *World Politics*, July 1949. Another even more striking, indeed a truly spectacular example of what can be achieved by liberal economic policies, is the amazing improvement that has taken place in Germany since June, 1948. At that time and at one stroke repressed inflation was removed by a drastic currency reform and the suffocating system of controls inherited from the Nazis, which had held the economy in a deadly grip, was swept away. These opinions are particularly remarkable in view of the severe criticism expressed by both authors of the policy of balanced controls as pursued in Britain and the Scandinavian countries (e.g. Professor HASSELER, "*Dollar Shortage?*" in S. HARRIS *Foreign Economic Policy for the U.S.*, 1949, and *Some Economic Problems of the European Recovery Programme*, *American Economic Review*, September 1948; also Professor LUTZ, "*The Marshall Plan and European Economic Policy*", Princeton University Essays in International Finance No. 9 (Spring 1948). They attributed the dollar shortage to the perverse attempt of European countries to live beyond their means and indulge in — repressed — inflationism, presumably to be treated by monetary panaceas similar to those practised in Germany, irrespective of the consequences internally and for the world economic system. H. MENDELSHAUEN, "*Prices, Money and the Distribution of Goods in Postwar Germany*", *American Economic Review*, June 1949) of the Federal Bank of New York, takes a much more balanced and sceptical view.

Much more serious is the fact that the representatives of the British Labour Government in the Military Government of Germany, especially the heads of the financial and economic administration, expressed during their terms of office, and perhaps even more freely after their resignation, unqualified enthusiasm for the policy pursued (e.g. Sir CECIL WELLS, "*Economic Development in Western Germany*" *International Affairs*, July 1949). The British Labour Government could not impose its domestic policy on the body of policy-makers abroad who were less exposed to publicity and whose decisions and policies had no immediate domestic impact (cf. my book *The Dollar Crisis*, esp. Chapter 3 (d), *The Executive and Planning*). This failure was much more important than the inevitable but sporadic intellectual and

It is said that the currency-reform, which put a sudden end to the state of « suppressed inflation » by annihilating excess purchasing power, together with the abolition of controls decreed simultaneously, has achieved a new « economic miracle ». The abolition of food subsidies combined with a reduction of direct taxation is said to have restored incentive and increased initiative lacking in controlled economies. The play of the price-mechanism, it is argued, has provided for an « economic » use of resources which planned systems are unable to achieve and thus sped recovery. The Government is precluded from unbalancing the budget by law and has no say in credit policy. Thus it cannot indulge in inflationism. The rate of interest is once more restored to its rightful place as the main director of investment. Western Germany, it is said, shows the resilience and effectiveness of the « free market mechanism ».

In this paper these claims will be critically examined (2); and the view will be put forward that:

moral weakness in the lower personnel connected with the difficulty of recruiting a large body of administrators at a moment when reconstruction at home demanded and offered splendid scope for talent. The uncertainty of tenure — which could have been avoided — however, immensely increased this difficulty. This failure of the Labour Government is not unique in the history of Social-Democratic administrations. Its lessons must be learned by those movements who wish to combine political with economic freedom and stable material progress.

(2) It might, perhaps, be added that no extraordinary foresight was needed to discern in advance the inevitable results of the policy criticised. Cf. e.g. F. BURCHARDT and K. MARTIN, "*Western Germany and Western Reconstruction*" *Bulletin of the Oxford Institute of Statistics*, Vol. 9 No. 12; also several letters of mine to *The Times*, 1946.

1) Little if any of the improvement in production can be attributed to the decontrol measures; it was mainly due to the restoration of money economy after the system of black-market barter which had evolved during the chaos following the collapse of the Nazi regime; and to the sudden increase in American supplies; despite these favourable factors the rate of increase in production did not at any time show any appreciable acceleration over the figure reached in 1946-47;

2) the iniquitous formulae for the currency reform adopted by the Military Government, contrary to German and Allied advice, resulted in a violent increase in social inequality as contrasted even with the Nazi period, amidst increased poverty; the simultaneous decontrol measures and the repeated regressive tax-reforms have not merely further aggravated social injustice and irresponsibility but also caused a flight into spending and goods to escape liabilities; consequently an open inflationary pressure made itself felt; consequently,

3) as there were no means left to canalise demand towards innocuous uses, harsh general measures had to be taken to cut demand generally;

4) in consequence employment could hardly be increased, and unemployment mounted rapidly despite hugely increased imports and the consequent disappearance of bottlenecks which prevented fuller recovery before the currency reform; the standard of life of at least 60 per cent of the population is still below decent standards amidst the wild display of luxury;

5) the productive effort of the country is at least 20 per cent below its potential capacity; such productive effort and especially investment as exist are to a considerable extent misdirected towards luxury consumption, the creation of palatial hotels, restaurants, movies and shops and industries catering for them; the mass-basis of German industry on which its competitive power depends, at tolerable standards of life for the workers, has been undermined; any effort to recreate it will involve a serious crisis, the inevitability and gravity of which will be increased with the passing of time, as the economic structure is now adapting itself to the

present — in the long run intolerable — pattern of the distribution of national income; only a carefully co-ordinated reversal of the present policy would enable Germany to escape an intensification of her economic malaise;

6) the weakness of the balance of payments despite the savage deflation practised shows the total irresponsibility both of the Government which encourages the inflation of higher incomes, and of their owners who recklessly consume it; the position is further aggravated by a large-scale capital flight; the foreign viability of the country cannot be restored by present policies;

7) the weakness of the Trade Unions due to the currency reform does not merely prevent the restoration of a more decent social unity and equity but will imperil the future increase of productivity, as large-scale investment does not pay at the present low relative level of wages and high rates of interest;

8) the social iniquity; the inability to distribute the war burden over the whole of the population; the failure to settle the refugees and absorb the unemployed inevitably favour extremism; the fear of Russia and the memory of the fake-prosperity under the Nazis will, if a thorough change of present policy is not enforced, unquestionably drive the Germans into a dangerous political impasse which might imperil the peace of the world.

It will be contended that these features of the German position are not the consequences of the special problems confined to that country. They have a general bearing on the question of decontrol in all impoverished countries dependent on trade with an unstable world economic system. On the contrary, the German « experiment » would have resulted in an open vicious inflation and breakdown in, e. g., Britain and the Scandinavian countries because the Trade Unions in those countries would not have accepted this harsh reduction of their standard of life in favour of a tiny minority; and their resistance would have led to a monetary collapse.

I. - The productive performance.

1. — In trying to comprehend and assess the economic development of post-war Ger-

many the first and basic fact to remember is the failure of the Allied air-attack on Germany to destroy or even seriously impair her industrial productive potential (3). Subsequent destruction by land fighting was more serious but still did not impair the industrial power of Germany. The frightful devastation of the centres of the cities and the loss of a priceless architectural heritage and the undermining — so far as a large part of the population was concerned — of the basis of civilised life should not lead to an overestimate of the effects on machines which are less destructible. This is the price exacted by a false economic and military intelligence, and the muddled strategy of the Air Force commanders who mistakenly claimed successes in order to obtain a greater allocation of war material. The failure — not incomprehensible — to admit this fact was one of the main reasons for the blunders of the Allied Military Government in dealing with the German problem.

It is, of course, impossible to arrive at an accurate estimate of the intact or easily repaired overall post-war German productive potential. Taking into account the rapid expansion in industrial investment just prior to the war — raising the level of output about 20 per cent between 1936 and 1938 (4) — which continued well into 1943, we might put the maximum which could be achieved on the basis of repairs, rather than new investment, at between 110 and 125 per cent of the 1936 production which has been taken as the basis of most post-war German statistics. By introducing a multiple shift system and concentrating production on more efficient plant it might be even larger — provided manpower were available.

2. — This estimate of course refers to a maximum utilisation potential of a rationally

(3) Cf. for a detailed survey, unparalleled in war economic history, *The Effects of Strategic Bombing on the German War Economy*, « U.S. Strategic Bombing Survey », 1945, and for a concise summary, N. KALDOR, *The German War Economy*, « The Review of Economic Studies » 1945/46, pp. 33-52. The captured secret Nazi figures disclose an unsuspected large excess in German productive capacity especially in machine-tools at the outbreak of the war. The subsequent air-rail damage at 6 ½ per cent only wiped out part of the continued war-time increase. *Bombing Survey op. cit.*, p. 45.

(4) Cf. my article on *The National Economy of Nazi Germany*, « Economic Journal », 1935.

integrated and repaired productive system of the physical composition in existence in the Western German territory. In fact the successful switch of the bombing offensive from carpet-bombing to target attacks, the terrible upheaval of the population of the whole of Europe (5) due to ruthless Nazi pressure-gang recruiting of labour and their immediate reaction to liberation and, not the least, the disintegration of the administrative machine, left this imposing potential at the end of the war in complete chaos.

The most important physical bottlenecks constricting production were the absence of transport and coal. Most of the bridges had been destroyed, the lines and roads broken or damaged. Locomotives and rolling stock were out of action. The canals were cut and the ships and barges sunk. In the coal industry manpower had largely disappeared (6). Those who remained were old or undernourished with disastrous effects on productivity: production fell from 11.4 million tons per month in 1938 to under 3.0 million tons in 1945. As a large portion of this was needed to maintain coal production, transport and essential demand in Allied countries, allocations to German industry were even more sharply cut. Moreover the dissolution of the Nazi administration left the country cut into a large number of almost autarkic districts. The military administration were unwilling to permit any movement of goods for fear of denuding the area under their control without assurance of replacement.

3. — Given this unparalleled situation the first phase of reconstruction, carried out mainly under direct military control, and primarily from the viewpoint of military needs, was remarkably successful. Table I shows the movement of the general index of production.

It is seen that, apart from the disastrous winter of 1947, production steadily increased. In two years, 1946-47, it was doubled. It must moreover be borne in mind that, as production

(5) At the end of the war 7.13 million foreign civilians and prisoners of war were in the German labour force, representing 37.6 per cent of the manpower of all priority works (including mines). « Bombing Survey », *op. cit.*, pp. 34-35.

(6) From 425,000 in 1944 to 266,000 in 1945. Transport problems prevented the distribution of over 2.3 million tons of coal stocks in 1945.

of the basic materials expands, the allocations to marginal uses can be increased more than proportionally. With increasing production, moreover, a greater variety of products come to the market and an increasing proportion can be allocated to investment, *i. e.*

OFFICIAL INDEX NUMBERS OF PRODUCTION, 1946 AND 1947
(1938=100)

	1946				1947			
	I	II	III	IV	I	II	III	IV
Quarterly index	22	26	31	31	24	33	37	38
% change on previous quarter		+ 18.2	+ 19.2	—	- 22.6	+ 37.5	+ 12.1	+ 2.7

repair which reintegrates into the productive structure output capacity of disproportionately high effectiveness. Until the stock of easily repaired fixed capital is exhausted recovery should proceed at an accelerated rate.

4. — Most commentators — especially German and Allied officials — claim that the decontrol measures, the «freeing» of the price mechanism, have resulted in a spectacular increase in German production and productivity. They point to the sudden availability of goods, especially of more durable consumers' goods, after decontrol. Nevertheless the extent of this miracle is considerably exaggerated. This view also hides certain essential features of the German development. German production has undoubtedly increased since the currency reform. But this increase was far less than the

OFFICIAL INDEX NUMBERS OF PRODUCTION, 1948 AND 1949
(1938=100)

	1948				1949			
	I	II	III	IV	I	II	III	IV
Quarterly index 1938 = 100	41	43	55	64	71	74	75	81
% change on previous quarter	+ 7.9	+ 4.9	+ 27.9	+ 16.4	+ 10.9	+ 4.2	+ 1.4	+ 8.0

published statistics suggest, and at a rate which was not appreciably higher than that achieved previously. The crude figures are shown in Table II.

As can readily be seen the overall increase in these two years was unchanged at just under

50 per cent, almost exactly equal to that of the first period. In view of the cumulative easing of bottlenecks the performance can hardly be considered as miraculous. It still leaves Germany as the sole country in Western Europe well below the pre-war level, which in view

of what has been said in 1) ought to have been attained and surpassed.

5. — This is not the whole story. German statistics before the so-called currency reform have been even more inaccurate than they are at present (7). Current German statistical information is merely falsified in those branches where a certain measure of control is still retained, *i. e.* coal, steel, and agriculture and perhaps housing, and also in those branches in which a possibility exists of exporting capital, either through a falsification of returns, or through the so-called western gap in collusion with foreign interests. If the extent of this falsification is still important it can, of course, not be compared with the suppression of truth practised before the currency reform for reasons of speculative (black-market) gain. It has been

shown by the unexpected volume of hoarded goods which were thrown on to the market immediately after the currency reform that the authorities were completely unable to verify

(7) This is accepted by such a biased observer as Professor Lutz (*op. cit.*, p. 133).

their own statistics. In certain branches of industry the understatement might have amounted to as much as 50 per cent of total production. The general index of production as published, however, should be increased by anything up to 15-20 per cent in order to get a truthful view of the position. This correction should now be reduced to anything between 5-10 per cent; and probably nearer to the lower figure. Thus, if we amend the official statistics, the index number of roughly 50 (1938=100) for the first quarter of 1948 should be modified to 60 while the index for the first quarter of this year of some 84 need probably not be increased to more than 88-90. Thus the increase in production is only 50 per cent instead of 70 per cent. This compares with an

talked about, however, is due to the fact that, while the progress since June 1948 was suddenly made manifest to tourists, progress before the currency reform was carefully and malevolently concealed with the intent of making illegal pecuniary gains. To the superficial observer riding down the streets in a car the change must indeed have been miraculous (9).

6. — It would, however, be unjustified to attribute even such improvement as has taken place entirely, or even mainly to decontrol, as is very often done by interested quarters. It must be borne in mind that the beginning of that experiment in the middle of the year 1948 coincided with other momentous changes in Germany which permitted the diversification

AMENDED PRODUCTION INDEX, 1946-1949

TABLE III

	1946				1947			
	I	II	III	IV	I	II	III	IV
Amended index, 1938=100	26.4	31.2	37.2	37.2	28.8	39.6	44.4	45.6
% change on previous quarter		+ 18.2	+ 19.2	—	- 22.6	+ 37.5	+ 12.1	+ 2.7

	1948				1949			
	I	II	III	IV	I	II	III	IV
Amended index, 1938=100	49.2	51.6	57.8	67.2	74.6	77.7	75.0	81.0
% change on previous quarter	+ 7.9	+ 4.9	+ 12.0	+ 16.3	+ 22.0	+ 4.2	- 3.5	+ 8.0

increase from some 40 (8) to 60 in the year before the currency reform. The withholding of production was especially flagrant in the half year prior to the currency reform. The similarity between the productive performance in 1947 and 1948 is spurious: the winter of 1948 was particularly mild. The main factor holding back German production in 1946-47 was the unavailability of coal. Once coal production increased the supplies available to German industry expanded in geometric proportion as export and other basic needs did not increase equally.

The amended production index gives a very different picture (see Table III).

There is no doubt, of course, that German recovery was maintained and important advances were achieved. The miracle so often

of production which has so impressed outsiders. Among these factors the most important are:

(a) the increase in coal production as a result of the deliberately planned and selective incentive scheme, which could and should have been introduced much earlier. Coal output increased from an average of 5.9 million tons in 1947 to 7.2 million in March 1948 and apart from a slight relapse remained consistently high. The allocations to the German home market increased by some 40 per cent;

(b) this was combined with a very mild winter which reduced coal consumption and

(9) It is significant that the measure proposed by the Social Democratic economic expert, Agertz, that the Trade Unions should be associated in the control of factory in-puts and out-puts, the only means by which we could have effective secured control, was disallowed by the British Military Government, having been passed by several of the provincial Parliaments of the British Zone. Cf. below Section II (4).

(8) Amended from 33%. Cf. U.N.O., E.C.E. Report on the Prospects of Europe, 1948 p. 3.

left a much greater part for the marginal industrial use (10); coal allocations to industry more than doubled;

(c) at the same moment industrial imports which had been moving well below \$ 10 million per month in 1947 rose precipitately to almost \$ 70 million in June 1948. They steadily increased since and reached the level of some \$ 140 million in December 1949. The imports of raw materials expanded sixfold in spite of the recurrent incapacity to take full delivery of Marshall Aid, due to the monetary policy pursued, to which we shall return.

The importance of these factors has been overlooked even by observers who are not sympathetic to the present trend of economic policy in Germany.

II. - The background of the currency reform.

1. — We have demonstrated that the rate of physical recovery has not been materially increased by the fundamental changes in Allied policy after the rupture with the Soviet Occupation Authorities and the launching of a quasi-autonomous German Administration. The increase in production can easily be accounted for by the decisive expansion of Allied help to Germany, the expansion of coal supplies, and the consequent disappearance of bottlenecks and the restoration of a money economy.

It could be argued, however, that such recovery, as had been witnessed prior to the decontrol of the economy, had spent its force (11),

(10) To characterise the extent of the black market which went on in the guise of legitimate consumption one might give the example of the Reichsbahn (State Railways). Efficiency in coal utilisation increased by something like 30 per cent from one month to another showing the extent of the earlier pilfering and misappropriation.

(11) Throughout the period when the Allied authorities were directly responsible for the economic policy in Germany they blamed the Potsdam Agreements on reparations and the level of German industry on the one hand, and the refusal of the Soviet Occupation authorities to permit free movement of goods between East and West on the other, for the failure of their efforts to restore German production more quickly. Western public opinion was only too eager to accept this explanation which was espoused by independent experts (e.g. Lord BAVENOX in 'The Times', August 1946, and my rebuttal of his thesis). In actual fact the Potsdam level of industry was some 70 per cent of the 1936 level of production, i.e. some 100 per cent above the level of production in 1946. This alone should have been sufficient to refute this excuse. The complaint about

that what is now described as « planned » economy was constricting any further effort, and that it led to a maldistribution of available products through black-markets and a steady reduction of economic life to a state of barter.

2. — There is some force in these arguments. Germany since 1945 possessed no full monetary system. The rôle of the German Reichsmark which the victors found in Germany was restricted to obtaining the wholly insufficient food rations (other goods were no longer supplied in regular rations) and to the payment of legal claims. The effective means of exchange for all other purposes was the cigarette and to some extent conserves. But the most varied barter transactions flourished, not merely between private persons but also between firms and their employees (12). The distributive machinery thus completely broke down and an immense effort was needed by everyone to obtain the necessities of life which could no longer be purchased against money. The creation of any sort of acceptable currency, under any conditions, would have represented an immense gain. The fact cannot be strongly enough emphasised, however, that this increase in productive and distributive efficiency would have resulted from any currency reform. If the population has accepted the appalling injustice of the new regime without disorders, this can

the refusal of the Soviet to release surpluses, especially agricultural surpluses, was hardly better founded. The loss of the Eastern Territories to Poland and Russia, the agrarian reform, the loss of capital equipment and deliveries to the Soviet occupation armies reduced and depleted supplies on the one hand, and the increase in the population due to the removal or flight of the German inhabitants of the East increased demand. There was thus no agricultural « surplus ». Nor could it be expected that the Russian occupation authorities would be more willing to supply the Western Zones without any counter-value, than the Western Zones to each other prior to their unification. The Western Zones were not able to offer anything because of the low level of their output. The obstructionism of the Russian authorities in other matters and the increasing tension between East and West made an objective appraisal of the position, and therefore timely remedial measures, exceedingly difficult. The violent fluctuations in U.S. official opinion from the « parasitisation » plans of Mr. Morgenthau and the ensuing directive not to aid German recovery to the sponsoring of *laissez-faire* and the cessation of all reparation payments and lifting of all restrictions (and more recently insistence on planning) did not contribute to the objective handling of the German problem.

(12) For a good description, cf. H. MENDERSHAUSEN, *Prices, Money and the Distribution of Goods in Post-war Germany*, « American Economic Review », June 1949, esp. pp. 647-658.

be attributed to the lessened strain in obtaining its meagre share of necessities. In comparison to the previous position almost any change represented an improvement. But this fact must not be used to defend the particular form of currency reform and the coincident decontrol.

The Allies drifted by omissions rather than by positive mistakes into this appalling responsibility. The fact that they took over and operated (and to some extent extended) the mechanism of direct control introduced by the Nazis before and during the war contributed powerfully to the myth that they attempted and failed in « economic planning ». This myth will long bedevil economic policy on the Continent in general and in Germany in particular, immensely increasing the difficulties in the way of effective recovery and of independence from Marshall Aid.

3. — It is usual to blame the breakdown of the monetary mechanism on « suppressed inflation », on the existence of a vast volume of liquid purchasing power in the shape of banknotes and bank deposits accumulated as a result of the finance of rearmament and war expenditure, combined with the decision of the Allied powers to continue the price and wage stabilisation decreed by the Nazis in 1936. Most people had ample financial resources. Hence they had no incentive to work or to sell goods against money, the volume of which had lost all relationship with output as a result of the total collapse of production. The British Authorities, apparently, wished to remedy the position by permitting a rise in prices (while holding wages) (13). The U. S. Authorities on the other hand elaborated a comprehensive plan, the so-called Colm-Dodge plan. This would have eliminated the old currency and banknote circulation by establishing a new currency. At the same time it would have equalised the incidence of losses and burdens through a capital levy, mortgages on physical assets, and through issuing bonds to those who as a result of the war had suffered damage. Pending decision on these controversial matters the Western Allies

— unlike the Soviets — did not block even bank-balances (14). This failure further contributed to the abundance of purchasing power.

4. — At the same time the Western Allies, especially the British, pursued a policy of financial rectitude unparalleled in any country of Europe in the early period after the war. It was the economic consequences of this Treasury orthodoxy run amok which, though seldom discussed, wrought even greater havoc with the restarting of production, with incentives, than the failure to grapple with the monetary problem proper. Despite the almost complete stagnation and the appalling misery in their Zone which should have necessitated substantial social service expenditure, the British Military Government brusquely balanced the budget of its provinces. This necessitated an increase in direct and indirect taxes. As the rich had unblocked reserves and were adept at tax evasion, the real burden of new taxes fell on the poorer classes whose direct tax liabilities were deducted at source (15). Thus the incentive to labour was completely destroyed. The small amount which remained of wages after tax had been deducted was completely insufficient to sustain life. Hence black-marketeering was made even more attractive. Indeed few could afford not to take off time from their own profession to earn or obtain food or other supplies. So far as entrepreneurs were concerned the maintenance of the wartime prices resulted in serious losses as their costs rose sharply with declining output. It would have been unjustified to let prices rise as, with increasing output, costs per unit would have fallen again. A rise in prices would have led to wage demands and thus unnecessarily to an open inflation. In order to avoid losses, however, subsidies would have had to be paid. Thus the British Administration refused. Thus the German entrepreneurs had a direct interest either to limit production or to divert it to the black market. At the same time the British Authorities vetoed a bill which would have associated the Trade Unions — which had a direct interest in preventing the misappropriation of supplies, as this decreased legal

(14) CHAMBERS, *op. cit.*, p. 371.

(15) Cf. « The Times », June 18, 1946.

(13) KLOPFCK, *op. cit.*, p. 278. CHAMBERS, *op. cit.*, p. 373.

rations — with the supervision of deliveries. A more effective combination of measures stultifying their own aims could not have been consciously invented by the representatives of a Government which domestically successfully (if with some vacillation) applied a policy of balanced control and secured a new and important role to the Trade Unions (16). The contrast could hardly be sharper or more incomprehensible. In the French and U. S. Zones price control and financial policy was somewhat laxer. Moreover those Zones were much less industrialised and therefore less dependent on outside goods supplies. Conditions in those Zones were, accordingly, better.

III. - The currency reform and its social consequences.

1. — After the rupture with the Soviets and the breakdown of the Quadripartite Control of Germany the Western Allies proceeded to enforce a reform of the currency in their own Zones (17). At the same time they granted some autonomy to the German Central Economic Administration which they had established. On this pretext they refused to contemplate the German picture as a whole or to deal with it as a whole. The equalisation of the terrible losses suffered by some as a result of the war, plans for which had been elaborated and which carried the approval of a substantial majority of the population, were abandoned. Nor were measures taken to prevent the hoarders of goods, *i.e.* those who had flouted the orders of the Occupying Powers, to reap a reward and escape the burden of the currency reform. The prestige of the victors was damaged beyond repair. On the pretext of not wishing to interfere with « internal » German affairs they restricted themselves to what they pretended to be a « neutral » « expert's job » — the reform of currency. In actual fact, this « neutral » act inevitably represented a violent anti-social redistribution of German wealth and consuming power, rewarding and elevating the least worthy elements in the community. It is un-

fortunately true that these are in the main also the classes which, because of their rabid pan-German nationalism, were in active collusion with Nazism and repeatedly became a menace to the world.

The main features of the currency reform are easy to sketch:

A) The German National Debt was altogether wiped out. This meant a reduction to penury without redress for the small saver worse even than experienced after the Great Inflation of 1922-23 when some compensation was granted. It also represented a deadly blow against charitable institutions and the Trade Unions whose means had been compulsorily invested in Government bonds — at a time when there was more need for their strength than ever before.

B) A new currency was created, under a series of laws promulgated in June 1948 (18). It was issued:

(a) to all holders of the old currency. Private individuals received a per capita allotment of 40 new Deutsche Marks (DM) against the same amount of the old Reichsmark (RM) and a further DM 20 was granted subsequently. Business firms were granted DM 60 per employee on the same basis. The old currency deposited and the bank deposits including savings deposits were blocked. Their subsequent conversion was undertaken at what appeared to be a ratio of 10 RM:1 DM. But this is deceptive. First of all the first personal currency allotment was debited against the deposits in the ratio of 10:1. This wiped out the first RM 540 of each individual's remaining money. Moreover only 5 per cent of the original amounts deposited were immediately released. The remaining 5 per cent was once more blocked and the last currency law issued in October 1948 wiped out 70 per cent of this blocked deposit and provided that a further 10 per cent could only be used for investment in bonds. Only 20 per cent (or 1 per cent of the old Reichsmark surrendered) was released. The conversion rate varied between 1:1 in the

case of people having less than 60 RM and somewhere between 10:1 and 15.3:1 in case of the better to do with liquid funds of over RM 600. This second confiscation, decreed four months after the original reform, had further disastrous consequences on confidence, while the existence of blocked deposits encouraged the starved consumers to « blow » their first allotments freely on wasteful purchases: They did not realise the full implications of the reform and hoped that more money would be forthcoming than it actually did. For this additional complication, the Military Government, which carried through the reform in stages, instead of making the whole scheme known at once, bears all responsibility;

(b) the Military Government and public authorities were given cash allotments; the banks whose assets had disappeared (as a result of the cancellation of the National Debt and a reduction of all private debts in the ratio of 10:1) were in part given cash allotments and in part State bonds.

Altogether in July 1948 the free German monetary supply had been reduced to just below DM 10 billions. Of this DM 5.5 billions were « new » cash allotments (subsequently increased to DM 6.9 billions) and DM 3.7 billions represented the conversion of the old currency (this expanded to DM 5.8 billions). In addition DM 1.4 billions new credit was created. This contrasts prior to the reform with roughly RM 119 billion banknote circulation and a vast amount of bank and savings deposits.

2. — The social consequences of this revolutionary convulsion of the monetary structure of Western Germany were immense and immensely lamentable. We have already pointed out that a large proportion of the total German output had been either misdirected into the black market or hoarded. Once the break between the Four Powers made a unilateral currency reform in the Western Zones inevitable the hoarding of goods assumed scandalous proportions. It accounts for the drop in the official index of production. These stocks of goods had been paid for by old marks. Once the currency laws came into effect these goods were thrown on the market.

The rest of the population with their newly issued money were confronted with goods long sought after, but hitherto carefully hidden. An orgy of spending broke loose; fantastic profits were made. Many entrepreneurs were able to convert their money wealth of old marks into new marks instead of a 100:7 on a 100:100 or even better basis. The liquidation of this mass of hoarded goods prevented an immediate breakdown of the new currency, swamped by the increase in the velocity of circulation. Equally important in this respect was the restraint of the trade unions which, in face of price increases, did not insist on higher wages. (The loss of the greatest part of their monetary reserves as a result of the currency scheme should, however, account for a considerable part of this restraint — in fact they became impotent). This spending spree transferred much the greatest part of the newly created money in the hands of a relative few and, in the main, of the antisocial class of hoarders and speculators. This had momentous consequences which go some way in explaining the present distress and unemployment in Germany.

Even so-called reputable firms have greatly benefited by the method of currency reform adopted by Military Government. Nothing shows this more clearly than the tremendous stock exchange boom which developed once decontrol, fiscal amnesty and the success of the anti-dismantling propaganda permitted the entrepreneurial class to admit their gains (see Table IV).

TABLE IV
SHARE PRICES
(in percent of nominal capital, December 1949)

	July 1948	December 1949
Basic industry	27.86	64.16
Engineering and metals	43.55	62.51
Other manufacturing	43.52	72.33

3. — It has been argued for the Military Government that they were not responsible for this regrettable aggravation of social inequality and reward for lawlessness. They had given instructions to the German Economic Administration to work out a scheme of capital loss equalisation through the imposition of a capital levy and distribute the burden fairly. In fact

(16) Cf. my essay on *The Dollar Crisis*, Oxford 1949.

(17) The U.S. and British Zones had already been combined.

(18) Cf. « Federal Reserve Bank Monthly Review », September 1948, for a detailed description.

it should have been known to the Governors that it would not be easy for the Germans to evolve, far less to carry out, a comprehensive plan; and that in any case the German Government (which they had helped to put into power) was far too dependent on, and favourable to the entrepreneurial classes who were the main gainers in the disorder and would not speedily agree to such a complicated scheme. Moreover, if such a scheme was not agreed upon by the Military Governors under the pressure of a simultaneous currency reform, its subsequent enactment (no longer spurred on by imperative need of agreement on the reform) was bound to be menaced by disagreements among the Allies. Even an intermediate reform, providing for *ad hoc* relief — not compensation — for those who lost all (Germany never had a war damage insurance fund) has been held up for months by the Allies. The British, somewhat illogically, wished to exempt the German firms in Allied ownership from all consequences of the equalisation of financial burdens. The failure to enact the scheme immediately has in fact prevented any effective subsequent action. With the passing of time not only the psychological but also the equity and economic basis of redress vanishes. The profiteers have been given an opportunity to secure their gains or at least utilize them through conspicuous expenditure. Through the wholesale decontrol this spending was translated into a distortion of the productive structure which has no justification and the readjustment of which is yet going to cause additional suffering.

Moreover with the smashing of control the equalisation of burdens would seriously interfere with the maintenance of day-to-day economic activity. The Allies thus have wittingly or unwittingly beggared the middle-classes and the workers just as they had been robbed by the Great Inflation after the first war. The instability of the German social system has irremediably been intensified. The eventual political consequences cannot be estimated. The sole if unflattering excuse for the Allied policy is that they were unaware of the consequences of their own actions.

IV. - Decontrol and « inflation ».

1. — Attempts have been made in the U.S., in Britain and on the Continent to argue that « planning » cannot provide the « optimum » allocation of resources, as a Central Authority cannot either gauge the needs of the community or arrange the vast economic combination of productive factors (19). It is suggested that « free play of supply and demand on uncontrolled markets » will automatically perform this vital task. The German Economic Administration officially (20) put forward this explanation in defence of its decision to decree an immediate decontrol of most (21) commodities.

This rather ingenuous argument ignores several vital qualifications which have been known already by the classical school of economics at the beginning of the XIX Century and which have been further elaborated by Professor Marshall and his neo-classical successors. The two most important of these qualifications are of special relevance to the post-war position in Germany. First of all it is evident that the price mechanism can work satisfactorily only if the distribution of money resources is equitable. Otherwise the « rationing by the purse » will merely reflect injustice and resources will be misdirected towards the supply of inessential but effective demand while urgent needs remain unsatisfied. We must, moreover, assume that consumers are aware of all relevant facts and that their decisions are not influenced by irrational considerations (e.g. prestige to be won by conspicuous waste), causing diseconomies of consumption.

Secondly, and hardly less important, there must be no material disequilibrium between the existing pattern of demand and supply, for the market mechanism is an exceedingly tardy and imperfect means of readjustment, and if supply is scarce speculation is bound to lead

(19) Prof. ECKEN, in « *Economica* », August 1948.

(20) D. E. KAUFMANN, in « *Frankfurter Wirtschaftspolitik* », March 1949.

(21) Some price controls of which rents, basic foodstuffs and raw materials were the most important were retained. Rationing or allocation was also continued on most of these, but in practice was either not or only extremely laxly enforced. Consumer rationing was altogether abolished early in 1950 except for petrol, the freeing of which was recommended by the Allied High Commission.

to an aggravation of the unbalance. In that case, moreover, price movements are likely to have the result of choking off demand rather than increasing supply. The doctrine on which the eulogy of the price-mechanism is based presupposes perfect competition and the absence of uncertainty. It disregards moreover the social cost of readjustment.

But the concept of shortage is itself ambiguous. Apart from certain goods, the demand for which does not increase, or even falls, as income increases, shortages will depend not merely on the state of supply, but also on the level of demand, *i.e.* national income and spendable liquid reserves. The theoretical argument showing that rationing decreases enjoyment as compared with that obtained from the same money income at identical prices without rationing is incontrovertible. It neglects, however, the fact that in the absence of controls it might not be possible to maintain the same level of money income without leading to a rise in prices and/or to worsening of the balance of payments. If the demand for certain commodities must be reduced, and the demand for those goods is very intense, the general lowering of incomes required in order to achieve the desired cut in consumption might have to be very sharp. In order to dispose with rationing and other physical controls, money resources will have to be made the narrowest bottleneck in the economy. In the short run, when resources cannot be shifted without undue social cost, the abandonment of controls might have to be paid for by sharp unemployment, or at least the under-employment of resources which at the margin do not absorb factors of production in proportion to the outlay, *e.g.* entertainment, travel, etc.

To give a physical illustration: if someone were to desire to dry up part of a lake, he could put up a cofferdam and pump out the water behind it. The water in the lake would rise, but if the sides of the lake were well buttressed, nothing catastrophic would happen and the operation could be accomplished with the least physical disturbance to neighbouring areas. If the same undertaking were to be attempted by a lowering of the level of the water in the lake, enough would have to be

pumped away to leave the area enclosed by the cofferdam dry. It would be an accident if other land would not lie above the level of the strip to be drained. If so, it would get parched in the operation, whether we want it or not. The lesson is plain.

If viewed from this angle the reputed lack of subtlety of direct controls does not appear to be so great as compared with general financial controls. In a country such as Germany which has been sundered by the cold war and lost the balance of its productive structure, and which depends on foreign trade to the same extent as Britain, this consideration is of special importance. Controls over production and consumption represent the most effective and flexible means of imposing selective pressure, equivalent to localized deflation, on industry without incurring the need for a general cut in incomes, causing unnecessary hardship and unemployment. It will be possible to isolate internal purchasing power from interfering with the export drive in individual essential exports industries. It will be possible to cut the consumption of certain goods which most depend on relatively expensive imports. It will be possible to concentrate on those lines of production in which success in exports is most likely, without having to curtail expenditure and employment unnecessarily in others. By direct controls demand can be cut to fit in with productive or import-export bottlenecks, and the resulting excess demand directed to innocuous uses, *i.e.* uses which do not absorb additional factors of production, *e.g.* entertainment and travel.

2. — The second and even more serious objection to decontrol in European countries, especially in Germany, is that the war and its aftermath has unbalanced the productive structure and the readjustment can proceed only slowly. If an attempt is made to cut demand by general measures to fit in with the narrowest bottleneck, this will result in unemployment elsewhere, and, what is even more important, it will necessitate a decrease in investment, *i.e.* a decrease in the rate of progress and in particular in the rate at which a balance of the productive structure can be achieved. Controls can adapt demand to the existing productive

structure, using the latter to the full. General monetary measures cannot accomplish this task, hence cannot guarantee a high level of investment and full employment.

The fact is sometimes quoted against the use of controls that they maintain « artificially » a structure of production which has become inappropriate. This is perfectly true, but does not constitute an argument against controls. Adaptation is bound to be slow as has been shown in the inter-war period. While maintaining full employment, special steps must be taken to promote readjustment. But nothing is gained by imposing a general deflation. This will retard the emergence of a new equilibrium as it discourages investment generally. Controls are therefore far less inimical to an adaptation of the economic structure to a new situation than the free working of the price mechanism. If disinflation does not cause large-scale unemployment, the pressure on individual firms seems hardly adequate to force them to engage in an all-out price struggle which would further worsen their position. It is more likely to strengthen the trend towards tacit or explicit restrictive practices. Instead of reorganization, standardization, and new investment in order to increase productivity, a cut in wages is surely more likely in a period of deflation and unemployment. Thus the main aims of all economic policy would be vitiated.

3. — Finally we come to the problem of determining the rate of progress. Classical theory postulated that an optimum distribution of resources will take place not merely as between alternative uses, but also between current consumption and accumulation, by the interplay of supply and demand on the capital markets. This view disregards not only that the rate of savings will depend mainly on the level and distribution of national income, but also that individuals, when making their decisions cannot be in possession of all relevant facts — especially long run considerations — and even if they were cannot be certain (except in the case of self-finance) that their decision to save will become effective and not be frustrated by the failure of investment to balance savings

decisions. The claim of the adherents of free market economics that the mechanism automatically establishes a unique position of equilibrium and secures an optimum rate of progress has been proved fallacious by modern economic theory.

The decision as to the rate of progress must be taken collectively, having regard to the relevant factors affecting the community as a whole, and with due consideration not only of national problems but also of international prospects. It seems essential, therefore, not only to reserve the decision on the rate of saving to the community as a whole, acting through constitutional channels, after due discussion of the relevant issues, but also to render this decision independent of the distribution of the national income. It would be intolerable if the need for quicker progress should result in enforcing a greater inequality of income distribution so as to bribe the rich into saving — having first increased their conspicuous spending — as actually happened in Germany by deliberate policy. Both aims would, however, require the maintenance of direct controls. If the second is to be attained, savings will have to be either collective, *i. e.* through a budget surplus, or collectively enforced, *i. e.* by maintenance of rationing. A budget surplus alone, however, would not guarantee that a degree of dissaving would not ensue, sufficient to reduce net savings below the rate desired. Moreover, the increase of the rate of taxation beyond a certain point is likely to have unfavourable effects on incentive, though the inter-relationship is more complicated than is usually assumed. It can be, and has been argued, that rationing by diverting excess purchasing power towards innocuous uses has the same disincentive effect as taxation. While, in the one case net income after taxation is reduced, in the other the range of choice of the commodities or services for which the income can be used is restricted, *i. e.* income is made less attractive. It has been shown during the war, however, not only in Britain but also in Germany, that the public regarded taxation measures, including forced saving, as a greater deterrent than the lack of opportunities to spend. The argument which assumes that a

restriction of choice immediately decreases effort also seems to imply that only the middle classes have any desire for accumulating reserves for retirement or against unexpected contingencies. This may be so, but no proof as yet has been furnished that this is in fact the case.

4. — These considerations seem to apply with unparalleled force to the German position in the middle of 1948.

The currency reform reduced the greater part of the German population to penury. Especially those whose property consisted of money claims, or had been destroyed or lost because of their flight or expulsion from their domicile, were in the direst straits. On the other hand the relatively favourable personal allocation of the new currency encouraged an irrational light-heartedness which permitted the hoarders to amass huge fortunes in the new currency. The fear of possible subsequent redistributive measures induced the latter to camouflage and dissipate their gains as speedily as possible. In consequence an inordinate wave of secondary luxury spending manifested itself and also induced large-scale investment in its supply.

This concentrated demand was confronted with a highly unbalanced supply. The German economic system ever since the recovery from the Great Inflation of 1923 was based on a mass-consumption demand and standardisation. The exigencies of the rearmament and war further strengthened this development. It was now suddenly left without this basis. The devastation of working class districts resulted in the channelling of such demand as the workers still had primarily towards food and clothing. On the other hand the destruction of the shopping-centres left the luxury demand without means of satisfaction. A careful combination of direct and fiscal control could have prevented the emergence of such vast inequality in effective demand. Illegal commodity hoards should have been taken over. Capital gains and the equalisation of war losses ought to have been dealt with before any readaptation of the currency took place. Priority ought to have been secured for essential building operations. This would have restored the mass-basis of German industry and prevented a distortion of the Ger-

man productive structure on the basis of the wholly temporary and artificial stimulus of the once-for-all gains due to the particular form chosen for the currency reform. This would have been essential even from the viewpoint of securing eventually a balance in foreign payments as it is unlikely that luxury products can find a sufficient market abroad to cover a substantially increased need for imports.

The Allied Authorities had already prior to the currency reform permitted a substantial rise in certain basic material prices, especially coal, « to strengthen the budgetary position by relieving it of the burden of subsidies » (such as they were). This translated itself with a certain lag into a general rise in prices. The unbalance between supply and demand after the currency-reform accentuated the impetus of the movement (see Table V).

TABLE V
PRICE MOVEMENTS
(1938=100)

	Middle of 1947 (*)	June 1948 (*)	January 1949 (*)	December 1949 (*)
<i>Wholesale prices:</i>				
Agricultural prices	120-125	123.5	154.8	179.6
Industrial raw materials	135-145	175.6	216.2	204.5
Finished products	190-220			
Consumers	150-180			
Producers	215-240			
<i>Cost of living:</i>				
Total (old index)	125.6	139.7	143.3	
« (new index)		159	168	159
		(July)		

(*) Mendershausen, *op. cit.*, p. 650 on the basis of official estimates.

(*) Report of the Bank Deutscher Länder.

Both indices seem to underestimate the actual increase in prices partly because of incorrect weighting, partly because of the biased choice of the sample (22). The discrepancy between the movement of the price index of luxuries which had risen to 400 (1938=100), clothing, which rose from 200 to 272, and food which remained relatively low at around 160 per cent shows the direction and cause of the pressure.

As may be seen in Table VI, wages increased much less, though earnings rose more

(22) Cf. Mitteilungen des Wirtschafts wissenschaftlichen Institute der Gewerkschaften, No. 7, August 1949.

substantially, due to a lengthening of the working week from 82.5 per cent of 1938 in June 1948 to 89.7 per cent in December 1948 and 94.9 per cent in September 1949.

TABLE VI
WAGES AND EARNINGS
(1938=100)

	June 1948	December 1948	September 1949
Hourly wage . . .	122.0	146.3	150.0
Weekly earnings . . .	100.7	125.8	143.0

It should be borne in mind that net earnings are very much lower because of the strongly regressive character of the German tax system which hits the lowest incomes far more severely than in other countries, or even in Nazi Germany. Tax evasion which will be discussed below adds to this distortion. These anomalies were further accentuated by the Tax Reform of the Allies. The reduction in property taxes was between 50-66 per cent, and of income taxes 33 per cent. Corporation taxes were made less progressive. At the same time excise taxes were increased. This « reform » was followed by further reductions on high incomes decreed by the German Authorities. They hoped to increase « thrift » by increasing spendable incomes.

The conspicuous luxury spending, the rise in prices were taken as « dangerous inflationary » symptoms, though mass-purchasing power remained far below the level which could have been satisfied by the German productive system if appropriate controls had been applied. This led to a severe and prolonged attempt at deflation from the consequences of which Germany still suffers, even though it was insufficient to restore (or even encourage hopes for an eventual restoration of) the balance in foreign economic relations.

V. - The deflationary decontrol.

1. — The experts of the Military Government and most foreign commentators (23) were exceedingly sensitive to the dangers of an in-

(23) Cf. especially Professor HANSELER (*op. cit.*) who expressed a fear of inflation at a time when unemployment had already reached the level of 1 1/4 millions or almost 20 per cent. Professor LUTZ complains that the personal allowance was made

flationary spiral as a consequence of decontrol. A series of laws was to guard against « political » interference with the working of the « economic » machine. They represent a mixture of the concepts of the organisation of the banking system popularised by President Jackson in the U.S. in the early XIX century combined with Montagu Norman's views of the role of the Central Bank and pre-1914 fiscal tenets on the management of the budget.

(a) The German joint-stock branch banking system was cut into artificial, « provincial » units organised on the basis of « Länder », *i. e.* irrespective of economic considerations. This obviously weakened their power of lending and resistance against business fluctuations. It also further increased the discrepancy between the large optimum unit size of industry and the size of the units in the financial system. In a country such as Germany, which had undergone such varied monetary vicissitudes, this was tantamount to imparting a definite deflationary bias to the economic system as the capital market does not, and for some time will not function and one of the, if not the, main channels of savings into investment has been, if not severed, at least severely impeded.

(b) The new German Central Bank has been given an organisation very much like a Federal Reserve Bank (with the difference that its « member » banks are the Länder Central Banks). There is however no superior Federal Reserve Board appointed by and responsive to the Government. The Praesidium of the Central Bank consists of Provincial « Central Bankers ». The institution has not only been made completely independent of Government influence, but the Government itself has been forbidden to borrow except on Treasury Bills of the original Goschen type (*i. e.* merely seasonal borrowing which must be liquidated within the budgetary period (24)).

(c) Thus the Government, and other public bodies, are not merely precluded to use their

too high and the second release of cash allowances of 1% of the original deposits decided upon without justification (*op. cit.*, p. 130). He apparently desires an even greater social injustice to make the price mechanism work « optimally ».

(24) Article 28 of the Military Government's Convention Law. Cf. below on a partial modification of this limitation.

borrowing powers to smooth possible economic fluctuations; they are positively encouraged to hoard. A further deflationary bias was until recently imparted by the withholding of the rapidly accumulating counterpart-funds representing the sale proceeds of the U. S. help through E. C. A. and War Department allocations. By the middle of 1949 the German public corporations had accumulated some DM 3,750 million deposits. Though they had received an initial allocation of DM 2,380 million this had been fully used in the first period when tax receipts were very low (25).

2. — The incipient rise in prices despite these powerful deflationary forces shows clearly the grave mistake committed by the decision to decontrol before the economic system was adapted to the new distribution of effective demand (if measures, in addition, were not taken to prevent the emergence of a completely anti-social and irrationally irrelevant pattern of that demand). It also shows the reckless drive of the main beneficiaries of the currency « reform » to convert and secrete their gains.

Nor was the « banking » control very effective. The supply of the new demand received lavish help. Restaurants, shops and

CREDIT CREATION
(million DM)

	Cumulative	Central Banks	Free Monetary Circulation
1948 July	1539	4	9962
August	2378	40	11802
September	3196	44	14054
October	3519	42	15281
November	4333	113	16415
December	4684	114	17308
1949 January	4901	87	17336
February	5263	69	18073
March	5551	172	18493
April	5887	342	19265
May	6124	311	19787
June	6407	401	20080
July	6823	314	20537
August	7625	239	20969
September	8060	264	21346
October	8872	259	
November	9502	232	
December	9848	447	
1950 January	10218	376	
February	10604	388	

(25) Report of the German Central Bank, October 1949.

other mushroom establishments catering for the luxury trades seem to have been able to obtain credit on a liberal scale at a time when public corporations were unable and unwilling to undertake the socially most urgent reconstruction work (see Table VII).

3. — In November 1948 the Central Bank decided upon a drastic deflationary policy. Characteristically it has been put through with a complete lack of discrimination or subtlety. The Central Bank increased the legal reserve ratios by 50 percent in case of demand deposits in cities (26).

The rate of interest was left unchanged but an embargo was put on new credits. Thus the main weight of the deflationary pressure hit new projects and businesses which had not accumulated funds through illegal hoarding of goods prior to the reform. The failures which resulted hit the new enterprises started by the refugees with particular force. This led to serious social and political consequences. Moreover, the tentative and rather blundering steps of the U. S. experts to diminish the resurgence of collusive (cartels) agreements between entrepreneurs and weaken the power of the great combines was set to naught. The financially strong emerged once more in an unchallenged position.

No effort was undertaken to safeguard the position by a skilful reorganisation of the capital market. Even within the narrow confines of a decontrolled economy much could have been but was not done to canalise investment towards the unquestionably just social priority of rebuilding the shattered cities and thus restore labour mobility. The fact that a large proportion of the refugees from the East, among whom, contrary to tendentious propaganda, a greater proportion was at an employable age and skilled than in the rest of the population, had to be temporarily settled in the less damaged — agricultural — areas rendered the solution of this problem even more vital economically, socially, and political-

(26) The U. S. system of legal reserve requirements was faithfully copied including the differentiation between demand and time deposits (the latter initially carrying half the reserve requirement of 5 per cent) which even in the U. S. is wholly illusory and must be ridiculous in a country like Germany.

ally, than it would in any case have been (27). Left far from possible places of employment they became demoralised. At the same time they were a constant irritant to the natives on whom they were quartered. No more inflammable social situation can be imagined.

The prohibition of all loan expenditure by the public authorities left only the method of organising a quasi-public financial institution charged with accumulating or canalising funds towards basic reconstruction. An attempt was made by establishing the Reconstruction Loan Corporation in October 1948. But funds could not be obtained in the open market. The use of banking funds was prohibited by the German Administration with the blessing (and probably also active connivance) of the financial experts of the Bizonal Allied Authorities. Thus until the spring of 1949 and amid growing unemployment, no funds were made available through this institution. When the Allied Authorities slowly began to be aware of the true significance of the position, they released some of the counterpart Marshall Aid funds to finance the coal-mines and electric power development.

4. — In the absence of any sustaining force, and with the exhaustion of the first wave of disordered buying and investment, the basic deflationary forces asserted themselves as could easily have been foreseen (and was foreseen by all but the German and Allied official circles). The German Trade Unions were impotent to prevent a relative worsening of their position partly because their funds had been lost through the currency reform and partly because of the growing unemployment. Thus a further increase of social inequality took place. The share of wages in the net industrial production decreased from 50 per cent in 1936, *i.e.* under the heyday of Nazi rearmament, to 42 per cent at the end of 1948. The real purchasing power of wages with due consideration to increased

(27) Out of 47.4 million total population in September 1949, 1.35 were unemployed. But out of 7.6 million refugees 0.48 were without jobs. The proportion is almost three times higher. The highest unemployment is recorded in Schleswig-Holstein, Lower Saxony and Bavaria. No powers exist to put them to work in their present domicile by a considered industrial location policy.

taxation and social security dues fell to 60-65 per cent of pre-war.

The ratio of indirect and wage taxes to total taxation also underwent a startlingly regressive change (see Table VIII).

TABLE VIII

TAX-YIELDS IN THE BIZONE, IN MILLIARD RM/DM

	1944	1946	1947	First half of 1949	Year 1949
	1945	1947	1948	1949	1949
Wage tax	1.4	1.8	0.9	0.9	2.1
Income tax	3.3	2.8	1.1	1.1	2.7
Corporation tax	2.5	0.6	0.7	0.7	1.5
Property tax	0.3	0.8	0.1	0.1	0.1
Turnover tax	1.4	1.6	1.7	1.7	3.1
Duties & excise	1.7	2.1	1.8	1.8	4.0

A further decrease of the taxes on corporations and higher income earners is contemplated to encourage « thrift », though no steps have been taken to ensure that the tax-remission is in fact invested and not used for hoarding, conspicuous consumption or capital flight (28).

(28) Cf. below. The capital flight has been officially estimated at DM 300-600 million *p.a.*, *i.e.* about 10 per cent of the required, and much higher proportion of actual, savings.

Cf. ECE, « Report on The Economic Situation and Prospects of Europe in 1948 », *op. cit.*

For an estimate of tax evasion the following comparisons are instructive:

	in milliards of national currency	
	Germany 1948/49	Britain 1948
Net national income at factor cost	65	97
Direct taxes on income and property (incl. corporations and including « Lohnsteuer »)	ca. 5.6 (or 7.9%)	2 (or 20%)

It is also interesting to compare the distribution of the tax burden with the Weimar and pre-war (Nazi) statistics:

Percentage on the total of:	1925	1933	1948	1949	1949
	1932	1939			(2)
Indirect taxes	37.3	41.3	38.7	47.3	43.5
Direct taxes (including wages tax but excluding local taxes)	34.4	36.4	44.7	35.6	47.3

(a) Including emergency levy.

Source: Wirtschaft und Statistik, April 1950, p. 26.

The decline of the importance of progressive taxes has been admitted by the German Central Bank (Monthly Report, January 1950, p. 12). It should be noted that the taxation on lower

5. — The fall in consuming power further contributed to the deflationary spiral (see Table IX).

TABLE IX

EMPLOYMENT AND UNEMPLOYMENT (thousands)

	Employment	Unemployment	Vacancies
1948 31 March	13204.6	471.8	757.0
30 June	13499.8	451.0	677.1
30 September	13497.9	784.2	297.2
31 December	13738.8	759.6	225.8
1949 31 March	13447.3	1168.4	196.7
30 June	13488.7	1283.3	144.6
30 September	13604.3	1313.7	127.9

To these figures some 200,000 unemployed in the Western Sectors of Berlin have to be added. It has sometimes been argued that the unemployment has been caused entirely by the influx of refugees from the Eastern Territories. It is, as we have already mentioned, inevitable that unemployment should affect the refugees much more than the inhabitants. The geographic distribution also indicates that the influx of refugees was one of the factors affecting the problem. In Schleswig-Holstein, Lower Saxony with 20-30 per cent unemployed, and Land Bavaria with somewhat below 20 per cent (the territories with most refugees and, incidentally, the areas most dependent on agriculture) unemployment is a multiple of the North-Rhein-Westphalian Land.

This is by no means the whole story. Employment in the earlier part of 1949 fell below that registered at the time of the currency

reform, and in the winter 1949/50, declined some 150,000 below the level of the previous year. This, however, does not show the extent of the unemployment due to the relative fall in demand, to pure deflation. With the breaking of bottlenecks and especially with the increase in foreign supplies, employment should and could have risen automatically much further if the monetary factor had not prevented it. Moreover the total conceals the fact that there was a substantial increase in employment in the « non-depressed » areas (though unemployment also increased) while employment was falling fast in the distressed territories

incomes is higher than in Britain and the progression is less steep (cf. « Mitteilungen des W.W.I. », *op. cit.*, No. 3/II). It should also be noted that a far larger portion of the British expenditure is on social services (including food subsidies). At both the British and the German taxes rise to 95 per cent of equal income it is clear that a vast portion of taxable income escapes fiscal control in Germany. The wholesale evasion of taxation is the more pernicious as direct controls no longer secure at least a tolerable distribution of the available supplies of necessities nor the concentration of the investment effort on social priorities. Comparison of tax-rates between Germany and Britain, which are often made to prove the crushing burden of taxation in Germany, are in the main irrelevant. Effective taxation should be compared. No statistics have been made available for the purpose.

The extent of the tax evasion renders all calculation of the national income on the basis of tax returns exceedingly dubious. Cf. Mitteilungen *op. cit.* No. 7.

6. — It is sometimes argued in Germany (29) as if the increase in productivity would by itself reduce the demand for labour. This of course is untrue. The income of those who remain employed (or of those who employ them) will rise. If hoarding does not then take place and is not induced by monetary policy, demand will rise and employment will once more expand. There is no reason to suppose that Germany is yet menaced by stagnation induced by an overexpansion of savings without investment outlets. The deflationary pressure is induced by a calculated policy.

The change in the distribution of unemployment between occupational groups is instructive (see Table X). Apart from white collar workers the burden is borne by unskilled labourers, building and metal workers, workers in transport and agriculture, *i.e.* those in general occupations not immediately depending on foreign trade. It is noteworthy that employment in agriculture and forestry declined about 20%; there was a smaller decline in service trades, woodworking and transport. Employment expanded in heavy industry, chemicals and consumer goods. This alone shows that rationalisation cannot account for the bulk of the rise in unemployment.

There can be no doubt that the influx of refugees has caused an awkward geographic and economic problem and has increased the immediate difficulty of attacking unemployment by general monetary measures. The future

(29) Sometimes even abroad, cf. *e.g.* the instructive article by Prof. W. W. HELLER. *The role of fiscal-monetary policy in German Economic Recovery*, p. 5.

TABLE X
EMPLOYED AND UNEMPLOYED IN WESTERN GERMANY
(three Western Zones)

December 1949; by occupational groups, in thousands

Occupational Groups	Employed	Un-employed
Agriculture, horticulture and stock-farming	1,007.5	113.5
Forestry, hunting and fishery	135.6	18.4
Mines and related occupations	438.2	9.4
Quarrying, ceramics and glass	158.8	28.4
Metal production and manufacture and related occupations	1,964.7	181.6
Musical instruments, toys	8.4	2.8
Chemicals	111.8	7.2
Rubber, asbestos and related occupations	35.0	3.6
Textiles production	315.0	25.8
Paper production and processing	67.5	5.1
Leather production and manufacturing, and related occupations	92.0	76.4
Wood, processing and related occupations	477.8	53.3
Food and stimulants	345.2	60.2
Clothing	532.9	65.1
Hairdressing and other hygiene occupations	91.7	13.2
Building and related occupations	772.5	128.2
Graphical occupations	88.6	5.2
Public and private health occupations	62.7	5.8
Film production and stage workers	0.2	0.3
Hotels, restaurants	180.7	40.3
Transport	1,121.8	125.4
Domestic service, etc.	920.8	73.9
Unskilled workers of all kinds	1,044.7	198.7
Machinists, stokers, etc.	116.7	9.4
Commercial, white-collar and administrative occupations	2,629.5	219.5
Engineers and techn. workers	302.6	30.9
Other occupations	502.7	54.5
Workers without constant occupations	10.3	58.8
Total	13,556.2	1,558.5

Source: Wirtschaft und Statistik, No. II, Febr. 1950.

increase in potential manpower might be undoubtedly greater than the present employment statistics suggest. The ratio of working to total population has sunk abnormally low. It should increase again as time passes, as prisoners return, and as the young born at the high Nazi birthrate enter employment (30). Even so, the expansion in the number of employables (exclusive of those « set free » by

(30) Returning prosperity raised most birthrates slightly in the late thirties. In Germany, special pro-natal policies raised it from 14.7 in 1933 to 20 in 1940. See, F. W. NOTHSTEIN, *The Future Population of Europe and the Soviet Union*, p. 29.

technical progress) should not be more than 2.5-3 million (see Table XI).

TABLE XI
WORKING POPULATION
(in millions)

Date of reference	Working population	Increase	Total employment	Increase
June 1936	18.75	+ 2.48	17.87	+ 2.10
Sept. 1949	21.23		20.13	
June 1952 (estimated)	22.95	+ 1.72	21.13	+ 1.0
Total increase		4.2		3.10

7. — The German Federal Government assumes that unemployment will rise by another million by the end of Marshall Aid. The U. K. offers a comparison. Its unemployment, like Germany's, was concentrated in special areas; yet while its population rose by some 3 million between 1936 and 1949, unemployment fell from about 2 million to about 300,000.

The German Government still doubts its power to rid Germany of unemployment. This scepticism might perhaps deserve respect if the Government had already taken financial and direct action to concentrate investment on two things: promoting employment where the unemployed now are, and promoting housing where there is already potential employment. This has not been done. Here it is well to remember a lesson of British experience before and during the war — that where there is heavy general unemployment all over the country, many people who would move if only jobs drew them, will stay where they are. There is a very fluid frontier between « structural » and « deflationary » unemployment.

8. — If more proof is needed of the importance of deflationary pressure in causing unemployment (i. e. reversible unemployment) it is provided by a further analysis of the changes in employment. In 1949, during the period of active deflation, the increase in unemployment was proportionately sharpest in industrial areas. In the Rhineland it amounted to about 100 per cent, while in the « refugee » or « distressed » areas it was less than 70 per cent. The shrinkage of unfilled vacancies was continuous

and more marked in the industrial than in the distressed areas. As between industrial and distressed areas we can also compare the rate of increase of unemployment in different occupations. The comparison shows the usual signs of secondary shrinkage: the consumers' industries depending on the earning power of the workers were heavy sufferers in the distressed areas. On the other hand, the increase in employment in the « expanding » industries in the depressed areas was decisively less than in the more « normal » areas. This shows that by now the cumulative deflationary process has gone some way.

VI - Attempts at reversing the trend.

1. — The increase in unemployment and the cessation of the cumulative increase in most prices led somewhat belatedly to a partial reversal of the deflationary policy in 1949, without,

TABLE XII
RELEASE OF FUNDS
(Million DM)

Date	Amount	Origin
14. IV. 1949	110	GARIOA
6. V. 1949	135	GARIOA
7. VI. 1949	14	STEG
17. VI. 1949	20	STEG
21. VII. 1949	10	GARIOA
2. VIII. 1949	10	GARIOA
15. IX. 1949	57	ERP
26. IX. 1949	20	GARIOA
8. X. 1949	50	ERP
14. X. 1949	44	ERP
12. I. 1950	543 (a)	ERP
15. II. 1950	57	ERP
From 14. IV. 1949 to 28. II. 1950	1,050	

(a) Of this DM 20 million have been used for repaying 20 million DM from G.A.R.I.O.A. which have been released on September 26th, 1949.

Source: Monatsberichte der Bank Deutscher Länder, Febr. 1950.

however, even partial success. Up to April 1949 none of the counterpart-funds withdrawn from circulation — which were accumulating sharply as the imports of food and raw materials gathered speed (31) — had been released. Since that date the releases were made at an accelerating rate (see Tables XII and XIII).

(31) Cf. below.

TABLE XIII
USE OF FUNDS
(in millions)

Date	Released	Used	Not yet utilized
1949 April	110	23.6	86.4
May	243	112.9	130.1
June	379	193.0	186.0
July	489	213.7	275.3
August	599	250.5	348.5
September	376 (a)	303.6	72.4
October	470 (b)	415.1	54.9
November	470	437.5	32.5
December	470	452.5	17.5
1950 January	993	622.7	370.3
February	1,050	799.8	250.2

(a) In addition, DM 94 mill. were appropriated but not released for distribution.

(b) Including the amount of DM 94 mill. mentioned under a), which was, meanwhile, released.

Source: ibid.

However, from Table XIV is seen that the releases were well behind the in-payments, especially in the latter half of 1949 when imports increased rapidly.

TABLE XIV
IN-PAYMENTS AND RELEASES
(Monthly average in million DM)

1949	In-payments by importers	Out-payments through releases	Balance
I quarter	597	412.9	+ 184.1
II "	474.6	597.9	- 123.3
III "	724.1	504.1	+ 220.0
IV "	890.0	470.0	+ 420.0

The increasing preoccupation of the Allied Authorities shows that they began earlier than the German Government to realise the consequences of their policy.

The balance sheet of the Central Bank merely dates the transfer of released amounts to the various institutions charged with channelling them; this does not necessarily coincide with the actual use of these resources in the economy.

Such the most important of these was the Bizonal Credit-Institution for Reconstruction. The French Zone and Berlin received lesser amounts. Of the total hitherto appropriated (roughly DM 800 million) DM 246.5 million were spent on electricity; DM 231 million on

coal and DM 95.5 million on other essential industries. Building received only DM 23.7 million. Further funds amounting to no less than DM 1150 million had not been released early in 1950. According to rumours they are to be utilised to some greater extent to accelerate housing.

2. — Banking policy was also somewhat modified in 1949. Bank-rate was reduced from 5 to 4½ and subsequently to 4 per cent. In June the reserve ratios in banking places were reduced from 15 to 12% (from 10 to 9 per cent in non-banking places). There was a further reduction to 10 per cent (8%) in September. The ratios on time deposits at 4 per cent are now lower than even before the deflationary policy was initiated. The embargo on new credits was lifted. The expansion of credit which had been sharply checked, was once more accelerated, though not sufficiently to keep the volume of liquid funds in proportion to the increase of production. The Central Bank consented to finance investment and exports in anticipation of repayment by long-term funds (either counterpart funds or savings) (32). But the amounts were relatively small. Nor were the exorbitant effective rates of interest (between 9-12 per cent p. a.) lowered.

The Central Bank, as we mentioned, was independent of Government control. Its leaders were hagridden by obsolete monetary theories. Only after a deflationary pressure made itself felt could belated and insufficient action be pressed on them (33). Unfortunately the Government itself was none too eager to press for such action. The artificially created excess

(32) In part through the rediscount of the long-term obligations of the States which had been issued to banks in connection with the currency reform to cover their obligations to the public in replacement of the old « Reich » Debt, which had been repudiated. The ceiling fixed by law on advances from the Central Bank to the Federal Government was increased and made more flexible.

(33) The division of authority between the Military Government (subsequently the High Commission) and the German Government gave ample scope for intrigue and manoeuvre for the Central Bank. The financial divisions of the Allied Authorities, moreover, were manned by « Experts » whose opinions did not seem to be justified by up to date economic theory. In the case of the U. S. the grave shortage of manpower and the rapid expansion of the foreign economic service (I.C.A. etc.) played an important role.

in supply (through a deficiency in demand) justified further decontrol measures. Any weakening or reversal of this policy would possibly have shown that decontrol was premature. Thus even amid immense and unnecessary suffering little energy was evinced in forcing the pace. The archaic character of the German Government's monetary theories has another illustration in their calculation of the possibility of financing investment from the accumulated savings in the banking system. It is supposed that some 25 per cent of new savings will have to be used to strengthen the banks' liquidity. Apparently nobody realises that the failure to offset savings by investments creates a deflationary gap, and that any attempt to increase liquidity must be defeated by the fall in national income. The depressing effects of such odd views as these are assisted, as noticed above, by the division of the German banking system into small and inefficient units.

3. — Nor was the so-called employment programme of the German Government conceived on more effective lines. It was announced with some flourish of trumpets that in 1950 — as a work creation programme — not less than DM 2.5 billions is to be devoted to building or reconditioning 250,000 housing units and in addition DM 950 millions to other investments. Unfortunately, like the release (or even « anticipatory » financing) of the accumulating counterpart-funds, this is in the main merely an offsetting but not actively expansive operation. The finance of the building programme — which shows an expansion of only 50,000 houses over 1949 as against a war-caused (34) deficiency of 5 million units — is to be undertaken mainly by channelling institutional savings or out of taxes and counterpart-funds (36). Only that part of the contribution of the Government which is financed out of the profits of minting new subsidiary coins — a very small part — could be considered « expansionary ». Central Bank credit is to be used only very sparingly and mainly as a temporary, short term loan to be repaid almost immediately from counterpart-funds and other

(34) I.e. excluding the expansion of the number of families.

(35) Bank Deutscher Länder, January 1950, p. 21.

« savings ». It is hardly to be expected that the temporary finance will be a sufficient stimulant to cause an increase in the national income (and subsequently also in savings) (36). The release of the « blocked » accounts (½ per cent of the original liquid funds) amounting to some DM 900 million is a somewhat more effective measure. Despite all promises the sterilisation of funds by a continued increase of public deposits at the Central Bank persisted even in the first half of 1950 (37).

4. — The whole problem is immensely complicated by the foreign trade and payments situation in which Germany finds herself as the result of the war, the loss of foreign markets, especially in Eastern and South Eastern Europe and the stifling of trade with the Soviet Zone. Unfortunately the policy of the Government, instead of minimizing the dangers arising out of this structural unbalance, was calculated rather to increase it.

The loss of trade with the Eastern Territories of pre-war Germany is estimated at some 2.7 billion pre-war marks (roughly equivalent to DM 5 billion). The division of labour and thus the interdependence were marked. Not only could the West obtain goods from the East but it also depended on it (and on Berlin) for a variety of electrical products, machines (textile and metal) and semi-finished and finished products (glass, wood, textiles).

The breach of these relations left the West with some exceedingly awkward bottlenecks (38). Perhaps the most important of these follows the loss of some 400 million pre-war marks worth of agricultural products (equivalent roughly to \$ 100 m. pre-war and \$ 200 m. present value). The increase of the population has further increased the dependence of Ger-

(36) Bank Deutscher Länder, Febr. 1950, pp. 9-11. It is characteristic of German « official » economic views that the use of minting profits for the finance of investment is considered less « inflationary » than the « creation of credit » by the Central Bank.

(37) This was admitted by the Central Bank. Cf. *ibid.* January 1950, pp. 11-14.

(38) Cf. U.N.O., E.C.E. Quarterly Report No. 3; also Mitteilungen, *op. cit.*, Vol. 3, No. 2, Febr. 1950. Cf. below however on the probable exaggeration of the difficulties of readjustment.

many on imports from abroad. To maintain an 80 or 90 per cent of pre-war standard of life equivalent, would require increased imports worth at least \$ 3-400 million, if steps were not taken to increase and diversify agricultural production and to render the economy less dependent on imports of raw materials in terms of the national income. Proposals of the latter kind are being at present officially discounted and attacked in Germany as « autarkic » (39) even though the country has come to depend on imports for about 55 per cent of her total requirements, as against 20 per cent pre-war.

It does not appear to be realised that this increased dependence on foreign supplies will inevitably react on the terms of trade and enforce a greater degree of economic self-sufficiency; nor that it would take an unnecessarily long time (and probably a deflationary crisis) to enforce this change through the unguided and unaided working of the price mechanism alone.

The loss of export markets to the East represents a loss of roughly 10 per cent of the total pre-war exports. It should not be forgotten, however, that the military (in contrast to the economic) autarky of the pre-war era had considerably intensified trade with the territories of Eastern and South Eastern Europe, since those sources of supply could not be cut by naval action in time of a war. On the other hand Germany is not at present permitted

(39) Even contributions which lay claim to detached scientific objectivity seem to seek refuge in declarations of mystical faith on this point. Thus, e.g. the Institutes of Social and Economic Research which jointly published a memorandum on « Full Employment and Viability » (Vollbeschäftigung und Lebensfähigkeit) profess to find some « higher » value in a liberalised trade in which no distinction is made between necessities and luxury imports. These views would seem to be justified only if non-discrimination would permit the maintenance of full employment and if, moreover, the distribution of income and wealth were « optimal ». As this is palpably not the case it is not easy to decide what policy would produce the most satisfactory results: far too many factors enter into consideration. From a social point of view the maintenance of full employment (with the minimum dependence on U.S. help) seems certainly preferable to the securing of additional chances for privileged consumers. If both can be combined it is probable — but still not certain — that a greater scope in international trade would be beneficial. Unfortunately there is good reason to suspect that most protagonists of « freer » trade hope by their advocacy indirectly to limit the scope of domestic social policies.

to trade with the Eastern countries as freely as are other members of O.E.E.C. (see Table XV).

FOREIGN TRADE WITH EASTERN EUROPEAN COUNTRIES Table XV

Country	Year	Imports		Exports	
		million \$	1938 = 100	million \$	1938 = 100
Germany	1938	334	100	317	100
	1948	75	22	67	21
Other Western European Countries	1938	818	100	510	100
	1948	1200	147	863	169

Source: Economic Survey of Europe in 1948. Dollar Values at fob. prices of 1948.

The expansion of British exports has immensely aggravated the problem of securing other markets without a serious worsening of the terms of trade — a most threatening contingency for all the highly industrialised areas of Western Europe.

Before the currency reform German exports were in the main restricted to raw-materials: steel, scrap, coal and timber. On this basis Germany could obviously never become self-supporting even if foreign markets were available. Even in the beginning of 1948 manufactures were only about 25 per cent of exports as against some 80 per cent in 1936. By the beginning of 1949 exports had increased sixfold and manufactures had recovered to 40 per cent of the total. A year later the overall was approximately doubled and manufactures recovered to all but 60 per cent of the total (see Table XVI). The policy of the Western Allies in starving Germany of industrial imports made her earlier recovery impossible.

After the currency reform this policy changed, but the change was not allowed to have its full effect. It was followed by deflationary

policy in the latter part of 1948, and (of less importance) by delays in releasing appropriations; these factors made it impossible for Germany to increase her imports sufficiently to absorb Marshall Aid and other foreign help that were available (such as drawing rights granted by the European member countries of O.E.E.C.). In 1948/49 Germany only used \$ 46.2 million of the total drawing rights granted of \$ 114.2 million (see Table XVII).

TABLE XVII
GERMANY'S IMPORTS AND EXPORTS (million \$)

Period	Imports	Exports	Deficit
1948 III. Quarter	404.3	168.9	- 235.4
IV. Quarter	353.3	198.0	- 155.3
1949 I. Quarter	411.5	234.3	- 177.2
II. Quarter	553.4	260.8	- 292.6
III. Quarter	521.7	271.1	- 250.6
IV. Quarter	602.2	263.1	- 339.1

In the second half of 1949 the acceleration of imports could only be financed by the accumulated reserve of unused appropriations, the O.E.E.C. part of which alone amounted to \$ 60.3 million. After the dollar crisis of 1949, with the pound devalued in terms of dollars and also in terms of the DM, it would have been wise to be watchful. In spite of the splendid harvest, which carried agricultural production almost to its high pre-war levels, the position remained difficult. The German Government decided, however, to decontrol a large number of imports. This it did although its long term plans predict the need to reduce the imports of necessities, especially from the dollar area: a reduction which may not be possible if the income of the poorer classes is allowed to rise. In consequence the balance of payments even with

FOREIGN TRADE OF THE BIZONE (million RM/DM)

TABLE XVI

Period	IMPORTS				EXPORTS		
	Food	Industrial goods	Raw materials	Total	Raw materials	Manufactures	Total
1936	66	131	81	197	27	171	227
1948 Jan.	73	44	23	116	15	11	43
1949 "	147	168	76	375	55	104	253
1950 "	303	461	237	964	84	243	443

European countries rapidly worsened (see Table XVIII).

TABLE XVIII
BALANCE OF PAYMENTS OF THE FEDERAL REPUBLIC WITH OTHER MEMBERS OF O.E.E.C. AND THE STERLING AREA (credit or debit balances - million \$)

Monthly average	6 countries to which Germany granted drawing rights (b)	3 countries to which granted drawing rights to Germany (b)	Others	Total
Actual balances of payments				
IV. Quarter 48	+ 5.6	+ 3.4	- 4.2	+ 4.8
I. Quarter 49	+ 19.6	- 1.4	- 2.8	+ 15.3
II. Quarter 49	+ 19.2	+ 0.2	- 13.5	+ 5.9
III. Quarter 49	+ 10.9	+ 9.2	- 7.6	+ 12.5
October 1949	+ 0.1	- 8.9	- 2.5	- 11.3
November 1949	- 28.5	- 13.9	- 9.0	- 51.4
December 1949	- 20.2	- 24.7	- 7.0	- 51.9
Planned balances 1949/50				
Total	+ 163.9	- 90.1	± 0	+ 73.8
Monthly average	+ 13.7	- 7.5	± 0	+ 6.1

(a) Austria, France, Greece, Holland, Norway, Turkey.
(b) Sterling Area, Sweden, Denmark.

5. — This surprising turn in Germany's balance of payments at a time when unemployment was rising sharply has been officially ascribed to exceptional causes unlikely to persist. The potential imports of Germany were mainly non-essential goods. Their delivery could be quickly arranged, while German exports, mainly ca-

liberalisation of trade has made capital flight easier; it has rendered Germany less capable of balancing her trade accounts without further sharp deflation, because of the distortion of the distribution of incomes and of consumer habits. There being no houses to buy or to furnish, demand develops for mass - «luxuries» of a non-durable kind. This increases the propensity to import. Finally, liberalisation of inter-European trade might make «soft» currency markets more profitable and thus — even with greater equilibrium in intra-European trade — decrease the pressure to force dollar exports (41).

6. — In view of the structural changes in the economy already discussed, it is not surprising that Germany should import now more than she did in 1936 (42). What is more serious is that imports of non-essential foods increased sixfold between 1948 and 1949, and in the last month of 1949 were some 30 per cent greater than in 1936. There is finally the astonishing increase in manufactured imports to more than 200 per cent (in December, 276 per cent) of the pre-war level, while raw material imports are still 20 per cent below that level and semi-manufactured imports have just reached it. This pattern differs remarkably from that to which, for example, Britain restricted herself as a result of the crisis in the balance of payments. The British national income increased, and it was better distributed. Yet British imports were held far below their pre-war level.

GEOGRAPHIC DISTRIBUTION OF GERMAN FOREIGN TRADE (million \$)

TABLE XIX

Year	IMPORTS					EXPORTS				
	Total	U.K.	Industrial Western Europe	East Europe	U.S.	Total	U.K.	Industrial Western Europe	East Europe	U.S.
1938	1836	101	274	254	130	2023	135	425	236	63
1947	960	85	96	31	585	434	77	230	22	6
1948	1814	99	264	72	892	883	108	457	50	30

pital goods, take a long time to export (40). Moreover, imports were at first increased by the need to reconstitute stocks. This done, a further improvement in the balance could be expected. There is, undoubtedly some truth in this contention. But equally the great

7. — The shift in German trade due to the disruption of the country and the consequences of the cold war was startling (see Table XIX).

(41) For a longer review of these points, see my article, *The Crisis of the Marshall Plan*, in «Economia Internazionale», 1950.

(42) Cf. however, on the problem of eliminating or circumventing bottlenecks, Part VII below.

(40) In the second quarter of 1950 exports have increased.

Not even in 1949 was any progress made in adjusting the dollar balance. Altogether \$ 3.1 billion worth of goods were delivered to Germany out of foreign aid (see Table XX).

TABLE XX
IMPORT SURPLUS AND ITS FINANCING
(million \$)

Year	GARIOA (a)	ERP	Total foreign aid	Import surplus
1945-6	532	—	532	44
1947	600	—	600	528
1948	884	142	1026	946
1949	536	420	956	1114
Total	2552	562	3114	

(a) Incl. British contributions.

In contrast to Britain, both the overall and the dollar gap have been increasing. While in 1948 foreign aid was greater than the import surplus, in 1949 the reverse was the case. The recent improvement is due more to the fact that the restocking has been completed than to an improvement in the basic relations between national income and imports.

The German Government has recognised the danger of a diversion of exports from the dollar area. Proposals have been made to encourage dollar exports by freeing up to fifty per cent of their proceeds from the obligation to surrender to the Central Bank. This measure might have some effect, in so far as it amounts to a hidden devaluation of the DM against the dollar. In present-day circumstances on the other hand it will probably intensify an already menacing flight of capital. Together with any further relaxation of control, a partial freeing of the dollar proceeds of exports represents a most awkward loophole. The system is already shaky, and this might finish it. The consequences are incalculable in a country exposed as Germany is to political dangers, domestic as well as foreign (43).

(43) The German Government hoped that liberalisation would restore prices to their « economic » level. There was little reason to hope for this desirable result. Other countries were also in the grip of deflation and would tend to transmit it through depression dumping.

The immediate resumption of intra-European cartel agreements showed the reverse obstacle in the way of the establishment of « equilibrium » prices.

8. — There are even indications that the present German Government had more in mind than the intrinsic merits of the scheme when they espoused the cause of European Union and liberalisation. The intrinsic benefits come mainly in the long run. In the short run the scheme makes any active social and employment policy difficult if not impossible; it thus preserves the status quo due to currency reform. The gloom of some official estimates suggests that such considerations did influence policy. The Government, for example, imagines that full employment would make necessary an increase of not less than 50 per cent (some \$ 500 million per annum) in imports of industrial materials and food. Even in view of the distressing level of unemployment, the figure seems high. It seems quite excessive when it is clear that a socially directed investment programme could and should minimize the need for imports — perhaps even without drastic physical controls. This pessimism strengthens the suspicion that a change of policy is not wanted (44).

9. — Unfortunately the Trade Unions are weak, and have grown weaker since the war. It is their business to defend the interest of their members and influence the policy of their Government. We have already pointed to the disastrous influence of currency reform in this respect. But their failure is to some extent their own fault. One of the more insidious reasons of their ineffectiveness is their concentration on the so-called « Right of Representation on the Boards of Directors », i. e. statutory power to nominate one third or one half of the members of boards of companies (and of public corporations). They already exercise some right in certain heavy industrial firms which were taken over and reorganised by the Allies.

The demand obviously has good motives. It is intended to democratise industry, and to give the workers representation and influence in the bodies that employ them. But there are serious objections to the method chosen to serve

(44) This is one more of those instances in which the German Government shifted the blame for a policy which is clearly antisocial on to foreign powers. Another crass example is the interruption of the Anglo-German trade negotiations in March 1950 on the plea that the Americans refused to permit the holding by Germany of sterling balances.

this useful purpose. First, it diverts much energy from other Union activities. Second, the Unions have not enough technically qualified members to represent them effectively. There is a danger that the men chosen will therefore be either unsuitable or unrepresentative — in either case the cohesion of the Unions will suffer. Third, from this lack of cohesion and because management makes managers, the Trade Union representatives are very likely to adopt a managerial attitude to their problems and also (which is worse) to their rank and file. The latter will lose their trust in their leaders, their solidarity, and perhaps their moderation.

Finally, it might be helpful if Trade Unions were represented on Development Councils embracing whole industries and on bodies advising the Government on general policy; but as a rule they are not. They are represented at the level of single firms, and in some ways their interests are there identified. This must further rigidify the economic system (and there is already enough interest in rigidity, without Trade Unions sharing it). It opens some frightening possibilities: may not Trade Unions, thus connected with single firms, come to support socially damnable policies? The way lies open to all those mistakes and abuses which marked the English restrictive cartels in the « thirties », or the « corporatism » of fascist Italy. It is odd, to say the least, that German (unlike English) Trade Unions have agitated more for « Representation » than for full employment which really does secure the human dignity of individual workers.

VII - Towards a rational economic policy.

The German Government tried to apply to real life an abstract, obsolescent and internally inconsistent economic theory; and certainly did not succeed. There are two tests of an economic policy: first, does it increase national income? second, does it distribute the products justly? The German experiment failed in both.

National output increased, but the increase was artificially slowed because deflation had to be enforced in order to avoid an open inflationary spiral. At the same time the dis-

tribution of the national income became more unjust than even the Nazis made it. The measures now contemplated by the Government will increase the inequality further. Moreover, this inequality directly induced a large scale misdirection of investment which threatens future economic complications. Only the patience and discipline of the German Trade Unions prevented the outbreak, in consequence, of acute social conflict.

It should be frankly stated that the mistakes of the Allied Occupation Authorities contributed and still contribute to the deplorable state of affairs in Germany. It is equally clear that even within the framework of a « liberalistic » economic policy the German Government could and should have taken wiser and more drastic action to minimize hardship and to stimulate economic activity in the right direction.

A) The Influence of the Occupation Authorities.

(a) First, and the most serious long-run effects are those due to the mistaken handling of German economic problems by the Allied Representatives immediately after the war. « Planning », so called without discrimination, was unfortunately discredited by what was in fact a planless direct control of the economy, already to a large extent practised by the Nazi regime.

(b) The Allies thus refused to treat as a whole the German monetary, economic and social problems, which are indivisible. They chose an insupportable scheme of currency reform. Introducing it piecemeal was the worst of several technical and psychological mistakes in its execution. All these blunders gave rise to acute social inequality. They caused the secondary boomlet of the autumn of 1948. They made almost inevitable the present creeping deflation. The Allied banking and currency « reforms » render corrective measures unnecessarily difficult if not impossible, even though some useful concessions have already been made, especially in allowing loan expenditure by the Federal and State governments.

(c) The Allies' policy on foreign trade, often contradictory, impedes reform. It also

affords the German Government a useful excuse for its refusal to undertake remedial action. The pressure towards indiscriminate liberalisation of foreign trade has been specially malignant. It was the pretext for the latest German measures. It helped to keep the dollar clause in the projected Anglo-German trade agreement. Waiving this clause, as was proposed, would certainly have helped to revive German exports and thus to secure important new sources of raw materials and food. In this matter some of the U.S. administrators in Germany have, in effect, interfered with a rational development of German and European foreign trade. This helps, of course, to frustrate an avowed aim of the European Recovery Programme — to make these countries less dependent on exceptional American aid.

(d) There seems to be clear evidence that the German Government is even less free to trade with the Soviet sphere than are most other member countries of the O.E.E.C. Any positive employment and investment policy is also severely hampered. In all these matters it is imperative that the Allies should agree, at the highest level, on a unified economic policy based on reality and not on dogma. The Allied experts were perhaps somewhat less than fair when they rebuked the German Government for the defeatism of its plans for the remaining period of Marshall Aid; the general tenor if not the detail of German policy had previously been both influenced and approved by other organs of the Occupying Powers.

(e) Much the same applies to more general problems of economic organisation. The measures, passed and contemplated, to break and reorganise cartels seem to be based on obsolete static economic theories; they take too little account of the position and problems of Germany, indeed of Europe. In particular the effects of this policy on relative European efficiency have been neglected. The « imperialistic » character of trusts and cartels and their threat to the democracies originated not in their economic but in their political activity. It can and should be remedied on the political plane by control, and not by isolated legislative acts, which will not increase efficiency or decrease

the monopolistic element in the price structure (45).

All the visible indications point to the renewal of most pre-war cartels (46). Such scant statistics as have been published on the distribution of national income show unequivocally that profit-margins and the degree of monopoly have considerably increased. The strong and consistent encouragement to « plough-back » company profits has obviously strengthened this trend towards monopoly by concentrating saving into the hands of existing companies. The virtual disappearance of an organised long term capital market is an additional factor tending with comparable force in the same direction. Little if any relief could be expected from the « reforms » proposed by the German Government in reducing the rate of tax on corporations and higher incomes: it is probable that most of the increased « saving » would still originate in the biggest firms. The gains to individuals on the other hand are more likely to increase conspicuous consumption and weaken the balance of payments (47).

Restoring the sequestered companies to their owners (though organisations are sometimes broken up, ownership is not) will obviously be taken as a sign of renewed Allied approval of the pre-war practices of Germany industry. The half hearted ineffectiveness of deCartellisation is another. The « break-up » of the former trusts was clumsily arranged and in

(45) It should be emphasised that deflationary pressure is also more likely to increase than to decrease the tendency towards monopoly.

(46) The American Authorities quaintly chose the abrasive cartel (mainly located in the British Zone) for their first attempt at criminal prosecution. One of the indictments was that they came to an agreement with their French competitors to pool and divide markets. The prosecution was begun at the same moment as the Schuman « Plan » of « pooling coal and steel resources » was launched by France with full American support.

(47) The Allied veto of the latest tax « reform » was made in the extreme and certainly was not based on social considerations but represented a rather unreasoned deflationary measure, in general contradiction to the earlier expressed change of the American Administration in favour of a more positive employment policy. These vacillations must bring further disrepute to Allied policy. The promised increase in taxes on luxuries is, to say the least, problematical. In the meantime there is nothing to prevent another spending spree by the few. As we shall argue it would have been prudent at least to confine the use of the gains of individuals due to the tax-remissions to certain stated purposes, e.g. housebuilding.

many instances reduced efficiency. The reversal of the policy is therefore likely to lead to excesses in the opposite direction: even the workable controls, e.g. price control, will not be attempted. The application of U.S. legal method in Germany is bound to fail. The whole problem is overshadowed by the need for European co-ordination. There must be planning. Europe cannot otherwise escape cut-throat internecine competition, and a worsening of terms of trade already gravely menaced by world economic developments (49).

(f) The lack of imagination and of purpose in the business of demilitarising and dismantling was — if possible — even more disastrous. Similar causes explain it. We have seen the reasons why at first the Western Allies, especially the Americans, pressed exclusively for reparations out of dismantled capital equipment. As the rift with the Soviet widened, the original view changed, but not quickly enough. The first « Level of Industry » plan negotiated with the Soviet might have crippled Germany and was abandoned. The dismantling next envisaged would not necessarily have damaged German prospects had a proper economic policy been pursued in other respects. Yet it was further modified and curtailed. Ultimately up to the end of 1949 only \$ 146.8 millions worth of capital equipment (at 1938 prices: at current values, some \$ 300 millions) was received by the Interallied Reparation Agency, which excludes the U.S.S.R. and Poland. The U.S.S.R. was to have received 25 per cent of the total capital equipment, and obtained instead, according to Agency's report, only \$ 12.5 millions (1938); according to the Western Powers some \$ 24 millions (1938) (49). Total reparations secured amounted to only \$ 517 millions, of which the U.S. obtained a surprisingly large share (\$ 103 millions) because of her success in impounding German assets. The last dismantling list reduced the number of plants to be surrendered to 680, a little more than a third of the already modified original

(48) Cf. my book on The Dollar Crisis.

(49) I.A.R.A. Report for the year 1949.

The total is probably less than the stolen capital goods acquired by Germany during the war and will certainly not reduce German productive power to the 1938 level even together with bomb damage.

list. Objectively, it seems clear that with some exceptions (e.g. fertilisers and steel rolling capacity) reparations as at present taken or contemplated did not and will not badly unbalance productive capacity. Nevertheless, as the whole policy of dismantling has become an object of haggling, and has never been properly explained to the German public, it should be ended quickly, and security measures concentrated on close control (50).

The right of exacting reparations from current production might however be reserved. It might well serve the purpose of « public works » and thus be of actual benefit to Germany. The possibility of a remilitarised Germany seems to depend rather more on the ruling psychology of the country (and also of the Allies) than on economic potential. The danger of the present policy is that it will first provoke dangerous extremes of political temper and will then be abandoned for internal or international reasons (51).

B) The Policy of the German Government.

Measures within the « free » pricing system.

When the responsibility of the Allies has been fully acknowledged (and it would be a great psychological mistake to minimise it), it remains clear that the German Government could have initiated a much more positive economic and social policy. Even without any fundamental change in its economic philosophy it can take steps to bring about a better utilisation of the country's productive power and a better distribution of the resulting output. It is also clear that a continuation of the present policy will aggravate the economic and social malaise.

(a) In the main the change of policy within these « liberal » limits will have to be

(50) The latest relaxation might impair this if the political position took a turn for the worse.

(51) The restriction on steel production will eventually have to be modified. But until effective measures are taken by the German Government to prevent the use of steel for unessential purposes, German complaints of the destructive effects of this particular bottleneck, or plans providing for large-scale imports of steel from hard-currency areas to prove the terrible hardships caused, ring somewhat hollow. It seems astonishing e.g. that large amounts of steel are wasted on ornamental fences and such frivolities.

confined to banking and taxation. Neither is (even in combination) capable of carrying the burden of a modern social and economic policy or ensuring full employment of the country's resources; but their reform could afford some relief.

1) The Central Bank will have to be brought under the control of the Government. There is hardly a country left in the world where the Central Bank is autonomous both in law and in fact. The German experience shows that the complete independence of the bankers within the State and their exclusive concentration on the bankers' business, the integrity of the currency irrespective of all other considerations, generates intolerable delays and frictions, the consequences of which threaten political stability. A unitary Central Bank under the State must therefore be created. In the same way the clearing banking system must also be permitted to concentrate into more economic units.

2) The existing Allied restrictions on the budgetary policy of the German territorial units, including the Federal and State Governments (52), will have to be lifted. Full open market powers must be given to (and used by) the Central Bank.

(b) On the basis of this « structural » reform an active policy of reconstruction must be initiated — which will incidentally increase employment. Work creation of the old type, useless work selected because it employs the maximum number, will not do. A country in Germany's position cannot afford it, especially in view of the short time left before foreign aid might diminish or disappear. Every effort must be concentrated on adapting the German productive structure to changed internal conditions and to the increased dependence on foreign supplies. In particular investment must be channelled where the social need is greatest and not left to the vagaries of a badly distributed effective demand.

(52) § 115 of the German Basic Law which forbids « deficit » finance is sufficiently flexible not to need amendment as it permits borrowing for « extraordinary » and « productive » purposes. The Allied restrictions have only been waived partially.

1) As long as the Government refuses to admit that the interplay of monetary demand and supply on free markets needs to be modified by direct controls to safeguard the position of the weak, so long will the problem of equalising the burdens and losses of war remain a really burning actual question. Controls make inequality tolerable by rendering the maldistribution of money wealth and income inoperative in the field of necessities. In the absence of controls, a comprehensive capital equalisation is imperative. Detailed plans involving a progressive capital levy were worked out long ago. They must be implemented straight away. The existence of the problem shadows the whole economic system, discourages investment, stimulates reckless expenditure and creates frustration and discontent.

2) Equally necessary is a reform of the tax structure (53). The proposal to render the income-tax less progressive seems odd when the effective (as contrasted with the theoretical) taxation of richer people scarcely reaches one third of the effective burden borne by the British. It has not been shown by recent experience that the willingness to pay taxes is increased by tax concessions. The system of permitting the indiscriminate charging of investment and personal expenditure by proprietors, managers and employers against income for tax purposes must be stopped even if it involves hardship. A large part of the offensive conspicuous expenditure is financed in this manner. Moreover, the uneven profitability of existing firms is due mainly not to economic reasons but to uneven monopoly power or partial control of certain prices (e.g. coal, steel, housing). Ploughed back investments (Selbstfinanzierung) are therefore not distributed in the most economic manner.

3) It is foolish, however, to expect that the price mechanism (even if an anti-monopoly Act be passed) can restore competitive equilibrium. Risk and oligopolistic elements will persist. On the other hand the social (and in the case of coal, the monetary) consequences of further decontrol of prices might be

(53) Cf. « Stellungnahme des Deutschen Gewerkschaftsbundes zum Gesetzentwurf der Bundesregierung zur Aenderung des Einkommensteuergesetzes », Jan. 1950.

serious and would certainly outweigh any advantage of restoring « economic » prices. A solution might be found in the housing sector, which is the most important, by using gains from tighter tax collection to finance urgent social investment (e.g. workers-housing) and/or by introducing tax-concessions on certain approved types of building projects.

It should be added that if a building programme is to succeed, investment and tax concessions must be confined to approved and efficient projects which are part of a systematic plan (including the replanning of cities). The institutions required for channelling State funds already exist (54). Tax and related measures could be used very effectively to influence the location of industry, a vital matter if the so-called « structural » unemployment is to be eliminated without unnecessary hardship. Tax-concessions, guarantees, cheap credit and the provision of other finance, and possibly the leasing of factory space built on public account, would help to attract entrepreneurs to the present distressed areas. Little initiative has been shown in this direction. In the same way classified taxes on land (and tax-concessions) could encourage and intensify agriculture and forestry.

4) Taxation can play a no less important part in lessening the discrepancy in consumption standards. It is imperative to increase the taxation of luxuries, especially luxuries which necessitate imports or which can be exported (55). Productivity could be increased by granting tax-concessions on standard products while increasing the tax-rate in excessive differentiation. The prospects of exports, which

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The problem of direct controls.

If taxation were sensibly reformed and used as a deliberate instrument of economic policy, it would probably succeed in reducing Germany's dependence (relative to national income) on foreign supplies. There would thus be less need for deflation and unemployment. The gain in national income would be considerable. The readjustment of the German productive structure would be easier and the reabsorption of refugees quicker. The investment capacity of the country (and therefore its productivity) could be increased without aggravating inequalities in the distribution of income.

(a) Germany is at present faced with an import surplus of some DM 3.5 billions. She has financed just under half of her imports from current exports. Even if we discount some of the wilder calculations about the probable effect on import-needs of an increase in her national income, it is unlikely that measures limited to the field of taxation could prevent a worsening of her balance of payments. In 1950 she can no longer draw, as she could in 1949, on accumulated balances and unutilised appropriations of U.S. aid. This alone will necessitate serious deflationary pressure, other things being equal. Even if the aid were not cut, Germany would still have to export more or import less. We cannot argue here about the chances of increasing exports westward, especially to dollar areas, under the conditions which are likely in the critical period ahead. An attempt has been made elsewhere (56) to show that an increase is improbable. An increase as big as Germany needs is virtually impossible (57).

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available there even in pre-war quantity; and the Eastern areas (apart from the Soviet Zone of Germany) never met more than a small part of Germany's pre-war needs. Even if it were possible to depend entirely on Eastern supplies, it would not at present be politically desirable. Thus only one real question remains: how precisely are imports to be cut? The choice lies between deflation and control. This fact is ignored by most commentators.

(c) Nonetheless, means must be found which will stimulate selected industries without worsening the general terms of trade. One such method is to foster exports systematically by limiting the proportion of sales in the home market, by agreement with the industries concerned. In this way it is possible to stimulate the efforts of entrepreneurs without deflating total national income (58). In order to enforce efficiency and to prevent cumulative speculative price movements in a tight situation, it will probably prove necessary to restore price supervision if not statutory controls. Combinations also demand attention. The renewed flowering of cartels and of restrictive oligopoly has decisively increased profit margins. This is socially intolerable. It is also economically wasteful. Only publicity and close supervision, with stronger statutory powers of price control at least in the background, can contend with it. It has also been shown that credit control cannot cope with the speculative withholding of stocks and its consequences — interrupted reconstruction and distorted patterns of income and production.

(d) In the same way some physical control of investment will also prove inevitable. The most painless and least difficult to administer is building licensing with the execution of which the Trade Unions can be associated. It should be possible by such controls to concentrate the available high investment capacity into housing and productive investment. If the latter is more evenly distributed over industry and geographically better located the rate of increase in productivity should remain high.

(e) It has been the fault of most post-war economic calculations that they grossly over-

(58) An effective control over the use of steel is certainly overdue.

estimated the investment needs of the community (59). By working multiple shifts bottlenecks can be eliminated and current investment needs reduced. True enough, depreciation is increased but with it increases its automatic finance. Moreover, a large part of factory investment consists not of machinery but of buildings and ancillary works (water, power, etc.) which do not depreciate proportionately to their effective utilisation. Very substantial results could be achieved in this vital respect by a sensible cooperation between Government, Industry and the Trade Unions.

It has been shown (60) that the utilisation of equipment before and even during the war was far lower in Germany than in other countries. One might expect rather startling results if energetic action were taken (especially if the provision of housing were equally determined). Opinions vary widely about the current under-utilisation of capital equipment. Most of them anyway leave out of account the possibility and the vital need of multiple shifts.

The pessimism and inaction of the Germans in this problem must be attributed to their desire for more U.S. economic aid and for U.S. help in getting rid of dismantling and reparation liabilities. It is by no means impossible that an energetic policy would very quickly increase production 20-30 per cent, with relatively slender new investment. The Allied Authorities and Trade Unions have not taken sufficient trouble to rectify the defeatist impressions created by interested parties. If this defeatism had some diplomatic successes it also made the reversal of the anti-social policy more difficult and thus endangered the evolution of a stable and balanced society.

Conclusions

The German problem is difficult, but only one thing could make it hopeless: a world depression, unmitigated by proper action in the

(59) The first version of the French « Monnet » Plan was an excellent example. Cf. Oxford University Institute of Statistics, Bulletin 1946.

(60) KALDOR, *op. cit.* The extent of most bottlenecks has been grossly exaggerated. It has been contended e.g. that no expansion of textile output is possible because of the loss of the spindle capacity which is situated in the East. This has already been shown up as wholly wrong.

monetary and commercial field (61). Some of the present gloom is self-created. In a deflationary atmosphere only the strongest can go ahead bravely, and they may not always care to. The pessimism prevailing in Germany, the lack of faith in her future productive performance, arise in part at least from the relative failure to mobilise available manpower (62). It is difficult to anticipate brisk activity if the brakes are always on. There is no real reason why production should not rise in the current year to, say, 125 per cent of its 1936 level (63). But as long as official circles delay investment until savings « mature », as long as their elaborate calculations prove a need for « additional — foreign — help », so long will they restrain and vitiate additional saving; so long will the increase in productivity be « enjoyed » in the form of increased unemployment.

It is true that some particular problems are more acute in Germany than elsewhere. The necessary readjustment is greater. Certain bottlenecks are narrower, imports not least. But these problems can be solved, if some of the rigid dogma of the Allied and German Govern-

ments will only yield to a business-like approach to difficulties as they emerge.

If such a change does not come, and come soon, then change of another kind will forestall it. Nothing but fast reform by free men can prevent the Western Germans from deserting political moderation for the militant extremes of right and left (64). Time, and a near example, are working against the West if nothing changes (65).

The democracies are fortunate that Soviet political intolerance and tenor and the appalling uncertainty of individual life, the loss of freedom, have so far restrained the Western Germans' revolutionary unrest. How long dare we rely on such a deterrent? The short-sighted in the Western countries find the Revolutionary Totalitarian Right less disturbing than the Left, and like to bet on one extreme against the other. Looking into Germany's future, they are actually comforted by the memory of National Socialism as an implacable enemy of Communism: could there be a more terrible measure of Germany's need today?

POSTSCRIPT (July 1950)

This paper has been completed in April 1950.

In the meantime the German economy has experienced a distinct revival. Industrial production reached the 1936 level in March 1950 for the first time (though it is still roughly 20 per cent below the 1938 level) and seems to have attained 110 per cent in June 1950 (*i. e.* 5 per cent above Dr. Erhardt's estimate of the 1952 level). Building activity has expanded even more quickly.

Dr. Erhardt, the Minister for Economic Affairs and his economists seem to regard this development as a conclusive justification of their attitude to economic problems and of the

« liberal » policy pursued. Nothing could be farther from being the case:

1) unemployment has remained substantially above the diurnal figure of 1949: 1.54 millions in June 1950, or 10 per cent, as against 1.28 millions a year before. The industrial areas, Rheinland, Westphalia, Hamburg, Bremen, show the worst proportional increases.

(64) In 1938, at a critical point in the history of Europe, I wrote « no complacency whatever is justified in the free countries, which seem to have failed in the task of utilising fully their far superior economic power, on account of the present economic position and outlook in Germany ». *The National Economy of Germany*, in « The Economic Journal », Sept., 1938.

(65) There is a final warning in the gain which the Soviet Zone of Germany has been able to record:

Production.	1938 = 100		
	1947	1948	1949
Western Zones	33	50	75
Soviet Zone	47	59	72

High reparations relaxed the Eastern gain is likely to accelerate. There is no unemployment in the Soviet Zone. There are no riches amid poverty, no Nazi collaborators prospering.

(61) Hence it seems incomprehensible that German authors should attack plans for maintaining full employment in creditor countries by international institutional measures.

(62) The target set by the German Government for 1952 was reached by May 1950.

(63) As against a German estimate of 105 per cent in 1952.

None of the structural problems is any nearer to its solution despite the grandiloquent employment creation « plans ». The level of production is still at least 15 per cent below the level which could be attained in the short run by appropriate planning and control;

2) apart from the expansion of building which has been powerfully assisted by the ERP-GARIOA programmes, the bulk of the improvement is a consequence of the improvement in the balance of payments. That this is not so much due to the internal policy of the Government as to the revival of the U.S. business activity is shown by the fact that improvement in the balance of payments of Great Britain, which pursued the opposite internal policy, was much more marked (it should be admitted however that the devaluation of the DM in terms of the dollar was 10 per cent less than that of sterling — though this hardly had an important influence on relative competitive power because of the discrepancy in wage-levels). The truth of the matter is that Germany, like most other European countries, benefited by President Truman's enlightened, Keynesian economic policy, which Dr. Erhardt and his « experts » try to discredit in their own country;

3) the further intensification of demand due to the recent turn in international political relations and the general rearmament to which it gives rise will certainly result in a continuation and intensification of this trend. The dollar shortage and the difficulty of obtaining markets has for the moment disappeared — however dangerous the reasons for the improvement. But all this shows the correctness of the Keynesian analysis and of Keynesian policy. Rearmament means merely an intensification of the policies advocated in this paper to relieve distress — alas only for destructive purposes (*);

4) such improvement in Germany as has been experienced was made possible *solely* by the moderation of the Trade Unions which held back wage demands. The worsening of the distribution of the national income continues. On this basis no doubt even Dr. Erhardt's system can be made to work. But it is unlikely (and undesirable) that the Trade Unions should consent to permit the continuation of this situation.

(*) It is significant, however, that few entrepreneurs lose « confidence » if it is rearmament which is financed and managed by Keynesian means. It is the change in their social status — implicit in social policies calculated to make democracy real — which gives rise to their resistance.